

Sri Lanka Handicrafts Board – 2016

The audit of financial statements of the Sri Lanka Handicrafts Board for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 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 Section 13 (1) of the Finance Act, No. 38 of 1971 and Section 64(3) of the National Crafts Council and Allied Institutions 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.

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 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).

1.4 Basis for Disclaimer of Opinion

As a result of the matters described in paragraphs 2.2 of this report, I am unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded items, and the elements making up the statement of financial position, statement of comprehensive income and statement of changes in equity, and cash flow statement.

2. Financial Statements

2.1 Disclaimer of Opinion.

Because of the significance of the matters described in paragraph 2.2 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.

2.2 Comments on Financial Statements.

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) The items costing Rs.297,392 awarded to various parties as donations had not been brought to account.
- (b) The value of the machinery of the Light Engineering Training Centre of the Board situated at Diggala Road, Keselwatta, Panadura had been assessed at Rs.3,988,500 and instead of eliminating the costs relating to those assets from the accounts, value of the revaluation had been eliminated from the accounts and that value had been again brought to account as the assets.
- (c) Owing to failure in maintaining the computer system used for billing items in the showrooms in an updated manner, a credit balance had been brought forward in a fake account named Damaged and Shortages Account over a number of years and as the balance of that account amounting to Rs.12,610,931 as at 31 December 2016 had been deducted from the value of the total trade item stock, the trade item stock had been understated by that amount.
- (d) According to the Board of Survey reports, the adjustments relating to the blemished and shortage stocks of Rs.20,487,237 had not been made to the averaged weighed cost in the financial statements as at the end of the year.
- (e) According to the Board of Survey report, the stock against the averaged weighed cost as at the end of the year amounted to Rs.446,650,807, whereas it had been stated as Rs.553,520,075 in the statement of financial position. Accordingly, a sum of Rs.106,869,268 had been overstated.

2.2.2 Unexplained Differences

The following observations are made.

- (a) The total indicated under the deposits and the pre payments in the financial statements amounted to Rs.9,632,106 and the balances brought forward over a number of years amounted to Rs.8,006,623. Nevertheless, those amounts had not been settled during the year under review.
- (b) The creditors balance amounting to Rs.349,452,232 shown in the financial statements included the debit balance amounting to Rs.3,575,929 resulting from the erroneous accounting. As that debit balance had been offset against the creditors balance in the preparation of financial statements as at 31 December 2016, creditors had been understated by that amount.

2.2.3 Lack of Evidence for Audit

The evidence stated against the following items of accounts had not been presented to audit and therefore, those could not be satisfactorily vouched or accepted in audit.

	<u>Item</u>	<u>Value</u> Rs.	<u>Evidence not made Available</u>
(a)	Lands and buildings	572,568,851	Register of Fixed Assets
(b)	Expenditure for the modernization of Laksala, Fort	43,751,410	Properly maintained files relating to the modernization of the building and the originals of the documents.
(c)	Computer and accessories	7,040,752	Register of computer and accessories
(d)	Loan from the Regional Development Bank	200,000,000	Documents such as decisions of the Board of Directors presented to obtain the loan and the authority in that regard.
(e)	Bank Loans	50,000,000	Loan agreement, decision of the Board of Directors and the loan file relating to the loan
(f)	Advances for the non trade purchases	5,120,760	Schedules and written evidence.
(g)	Machinery and equipment of the Katubedda Project	10,645,350	Board of Survey Reports.
(h)	Training equipment of the Panadura, Keselwatta Light Engineering Centre	3,988,500	Board of Survey Reports
(i)	Bank Current Accounts 05	1,755,249	Bank balance confirmation letters
(j)	Benevolent Fund	1,000,000	Bank statements, bank reconciliation statements and bank balance confirmation letters of the year 2016
(k)	Cash in hand of 14 showrooms	2,711,407	Cash verification reports.
(l)	Trade debtors	7,319,887	Debtors balance confirmation letters
(m)	Rental receivable	1,133,557	Schedules and balance confirmation letters or explanations
(n)	Bank security	4,382,321	Security Agreements
(o)	Retention money- Katubedda	12,002,564	Written evidence sufficient enough to confirm the balance
(p)	Trade creditors balance	325,249,698	Creditors schedule and balance confirmation letters
(q)	Work-in-progress	21,767,651	Clarifications and files relating to the identification of balance
(r)	Tax payable	40,306,326	Tax files and tax returns
(s)	Museum Stocks	1,962,845	Schedules and written evidence

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) The receivable trade balance totaling Rs.25,670,284 as at the end of the year under review included the balances totaling Rs.16,812,675 less than 01 year, balances totaling Rs.955,251 relating to a period from 01 to 3 years and the balances totaling Rs.7,902,358 relating to a period of 03 years and more. Nevertheless, the Board had not taken adequate steps to recover these outstanding loan balances.
- (b) The payable trade balance totaling Rs.357,164,648 as at the end of the year under review included the balances totaling Rs.196,265,316 less than 01 year, balances totaling Rs.114,966,469 relating to a period from 01 to 3 years and the balances totaling Rs.45,932,863 relating to a period of 03 years and more. Nevertheless, action had not been taken to settle these outstanding balances.

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

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

<u>Reference to Laws, Rules, Regulations, etc.</u>	<u>Non-compliances</u>
(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka	
(i) Financial Regulation 231 (1)	Particulars on the payments relating to 03 payment vouchers totaling Rs. 560,379 had not been submitted together with the payment voucher or separately for checking.
(ii) Financial Regulation 371 (c) and Public Finance Circular No.3/2015 dated 14 July 2015.	Sundry advance totaling Rs.10,469,988 granted for various non-trade purchases had not been settled even up to 31 December of the year under review.
(b) Public Finance Circular No.3/2015 dated 14 July 2015.	Despite lapse of a period from 01 month to 11 months, advances totaling Rs.981,531 granted in 33 instances had not been settled even by November 2017.

(c) Public Enterprises Circular

- (i) Sections 1 and 2 of the Circular
No.PED/57 dated 11 February
2011.

Although all publicity and promotional activities should be included in the Annual Action Plan and the approval of the Department of Public Enterprises should be obtained thereon, without being taken action accordingly, expenditure totaling Rs.9,758,983 had been incurred for publicity and promotional activities during the year under review.

- (iii) Circular, No. PED/12 of 02 June
2003
Section 4.2.6

Performance Reports had not been submitted to the Department of Public Enterprises and the General Treasury within the prescribed period.

Section 9.3.1

A scheme of recruitment had not been prepared and approval had not been obtained subsequent to the restructuring.

- (d) Finance Ministry Circular No.03/2015
dated 14 July 2015.
Section (b)

Approval of the General Treasury together with the recommendations of the Chief Accounting Officer had not been obtained in connection with the advances totaling Rs.4,018,748 paid exceeding the advance limit of Rs.1,000,000 in 15 instances.

- (e) Public Enterprises Circular
No.PED/05/2016 dated 16 December
2016.
Section 3.3

Without furnishing accounts to the Audit within the prescribed period, sums totaling Rs.2,133,000 had been paid as the bonus.

- (f) Letter No.DMS/G/3/60/2 dated 21
December 2012 of the Department of
Management Services relating to the
approval of staff.

Having recruited an officer for an unapproved post of Assistant Accountant on contract basis, sums totalling Rs.1,683,583 had been paid as salaries and allowances during the period from August 2013 to May 2016.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Board for the year amounted to a profit of Rs.4,027,790 as against the net loss of Rs.19,666,257 for the preceding year. Accordingly, an improvement of the financial result amounting to Rs.23,694,047 as compared with the preceding year was indicated. The above improvement had mainly attributed to the increase in the gross profit by Rs.21,760,500, other income by Rs.1,717,173 and decrease in the administrative expenditure by Rs. 4,817,323 as compared with the year 2015.

In analyzing financial results of the year under review and 04 preceding years, it was revealed that the Board had received a net profit from the year 2012 to the year 2014, whereas a net loss had been received in the year 2015 and a net profit had been received during the year under review. However, in readjusting the employees remunerations, Government tax and depreciation for the noncurrent assets to the financial result, the contribution of the Board in the year 2012 amounted to Rs.116,062,111 and with the annual improvements, it had been Rs.136,725,193 in the year under review.

3.2 Analytical Review

Several significant accounting ratios for the year under review as compared with the preceding years are given below.

- (a) The current ratio of the Board which stood at 1.1 in the year 2015 had decreased up to 0.96 by 13 per cent by the year 2016 and it had been mainly contributed by the increase in the current liabilities by higher percentage than the percentage of increase in the current assets.
- (b) The quick assets ratio of the Board which stood at 0.24 in the year 2015 had decreased up to 0.23 by the year 2016 and it had been attributed by the representation of 76 per cent of the current assets of the Board by the stock of trade items. Accordingly, quick assets ratio and the current assets ratio remained at an unfavourable level.
- (c) The net assets of the Board which stood at Rs.572,882,947 in the year 2015 had decreased up to Rs.561,271,942 by Rs.11,611,005 by the year 2016. Even though a profit of Rs.4,027,790 was recorded in the year 2016, as a sum of Rs.15,638,795 had been debited to the retained profit in respect of the surcharge unpaid to the Employees Provident Fund, the Employees Trust Fund, and the under provision for gratuity in the preceding years, net assets had decreased in the year 2016.

3.3 Legal Actions Instituted Against the Board

Due to failure to take action in accordance with the agreements entered into with the external parties by the Board, external parties had filed 02 court cases against the Board while an employee had filed a case against the Board by stating the fact that he was interdicted in an undue manner. Sums totalling Rs.729,383 had been paid as the legal charges during the year in respect of the cases being tried.

4. Operating Review

4.1 Performance

The main objectives of the Board include the expansion in the production of handicrafts in Sri Lanka and improving the quality thereof, sale and promotion of handicraft productions within Sri Lanka and foreign countries , and to do all such activities that the Board deems necessary for the achievement of the above objectives. The following observations are made on the achievement of the aforementioned objectives.

- (a) Although a declining trend was observed regarding the purchase of productions from the local handicrafts manufacturers following the year 2013, the purchases which stood at Rs.323,294,335 in the year 2015 had increased up to Rs.326,230,675 in the year 2016.
- (b) Although the local sale amounted to Rs.788,326,668 in the year 2015, it had decreased up to Rs.786,998,051 by Rs.1,328,617 in the year under review. The budgeted sale in the year under review amounted to Rs.1,200,000,000 and as such, the actual sales value represented 65.6 per cent of the budgeted sale.
- (c) Even though plans had been drawn to increase the sales carried out through the export and internet under the foreign market sale up to Rs.16,000,000 in the year 2016, that sales value had been Rs.2,762,175 and therefore, the progress had been 17.26 per cent of the expected target. Accordingly, a minimal level trend could be observed in involving in the foreign market. Nevertheless, the Board had spent a sum of Rs.5,304,110 for the promotion of foreign sales during the year under review.
- (d) Although the Board had planned to increase the number of show rooms from 14 to 16 in the year under review, that objectives had not been implemented owing to the financial difficulties.
- (e) According to the Action Plan, although plans had been drawn to implement a process of selecting the excellent seller, branch manager, supplier and the branch and awarding rewards during the year under review for the purpose of motivation, those plans had not been implemented.

- (f) The Board had been established with the objective of creating a wide market for the handicrafts manufacturers in Sri Lanka. The sales price of the articles had been determined by multiplying the purchasing price of the products by a profit margin ranging from 1.8 per cent to 4 per cent.

Accordingly, products costing Rs. 310,926,921 had been sold and an income of Rs.785,110,048 had been earned during the year under review, thus earning a gross profit of Rs.474,183,127. Accordingly, although the Board had earned an enormous profit by selling the articles with a massive profit margin on the productions of the craftsmen, as the financial and operating cost of the Board was extremely higher figure, net profit had decreased up to Rs.4,027,790.

Hence, the burden of the cost of the Board established with the objective of expanding the market for the productions of the handicraftsmen had impacted on the production cost of the craftsmen, thus resulting increase in the production cost and decrease in the sales.

4.2 Management Activities

The following observations are made

- (a) A three storied building consisting of 4,680 square feet capable of providing hostel facilities for 80 students had been constructed at the Carpentry Training Division premises, Katubedda by spending Rs.20,447,738 during the year 2006. The construction of its roof had been discontinued in the year 2008. The walls of that building had been cracked and it remained damaging. The management had not taken action to protect and use this building for an effective purpose.
- (b) At the Cabinet meeting held on 18 November 2012, a decision had been reached to the effect that the building belonging to the Lanka Salusala Ltd. Galle branch constructed at Unawatuna in Galle and its land should be legally vested in the Board. Accordingly, as a purchasing amount, a sum of Rs.15,248,575 had been paid to the Lanka Salusala Ltd on 12 December 2012. Nevertheless, action had not been taken to legally transfer this building and the land although a period of 04 years had elapsed by the year under review.
- (c) The tax liability payable as at 01 January 2016 totalled Rs.36,641,942 and that amount included the Value Added Tax, Nation Building Tax, Economic Service Tax and Income Tax. The Board had not maintained a separate control account relating to tax and all the tax payable had been recorded in this General Account. Action had not been taken to pay the recovered tax value amounting to Rs.6,934,192 included in the above tax liability.

4.3 Operating Activities

The following observations are made.

- (a) Due to the renovation activities of the Colombo Fort Laksala Showroom, the space thereof had been confined to a quarter of the space existed and the its sale had dropped by Rs.53,097,854 and Rs.7,138,637 in the year 2016 as compared with the years 2013 and 2015 respectively. Adequate steps had not been taken to complete the renovation activities expeditiously so as to promote its sale.
- (b) A stock of textiles and readymade garments costing Rs.789,274 that remained unsold at the sales outlet named special discount outlet maintained at the Thummulla Showroom Premises had been insecurely heaped up at the Katubedda Stores No.41. Out of these stock, some textiles remained either unusable or unsaleable condition and attention thereon had not been paid.

4.4 Transactions of Contentious Nature

The following observations are made

- (a) The Apegama Project initiated in line with the Commonwealth Heads of Government Meeting,2013 had been entrusted to the Ministry of Education by the Extraordinary Gazette No.1933/13 dated 21 September 2015. The following matters were observed thereon.
 - (i) A loan amounting to Rs.199,481,500 had been obtained by mortgaging the Laksala building situated at Colombo Fort and its land to a State bank in order to carry out all the constructions relating to the Apegama Project. A sum of Rs. 188,714,885 had been paid up to 31 December 2016 as installments and interests of the above loan.
 - (ii) For procuring goods and services for this construction and the business promotion activities, the Board and the other institutions had spent sums totalling Rs.221,073,822. Out of the above fund, sums totalling Rs.13,736,855 had further remained payable to the institutions that had carried out the constructions.
 - (iii) Even though the Board had spent a colossal amount of money for the constructions and improvements as indicated above, the value of the assets as at 31 December 2016 had been stated as Rs.30,580,126 in the financial statements of the Board. The collection of daily income of the project had been entrusted to the Ministry of Education with effect from December 2015. Nevertheless, the Board had failed to recover the expenditure incurred on the project although a period of one year had elapsed by December 2016.
- (b) Accounting of the Board had been carried out using a computer software named SAP (System Application and Products) and it was observed in audit that in carrying out accounting using this computer software, a back date can be included. Due to the unsafe condition of this computer system, there had been a risk for the conduct of pre audit on the account balances contained in the SAP software.

4.5 Idle and Under-utilized Assets

The following observations are made.

- (a) Due to the discontinuation of the Carpenters' training activities from the year 2011, the land of 02 Acres and 24.9 perches in extent situated at No.282, Galle Road, Katubedda, the Carpentry Training Centre containing 11,200 square feet in which 80 students can be provided with training at a time and the machines installed therein, teaching equipment, the timber stores of 2,090 square feet and two storied hostel containing 4,680 square feet including 40 double beds had remained idle for more than a period of 05 years.
- (b) The light engineering training equipment valued totalling Rs.3,988,500 of the Light Engineering Training Institution at Keselwatta, Panadura, new two storied building with the capacity of training 30 students at a time and old buildings and the land of 40 perches in extent had remained idle due to failure in using for training activities for over a period of 07 years from the year 2010.
- (c) As a result of closing down of the Wagolla, Welipanna No.02 Showroom during the year 2015, discolouration of articles and various renovation requirements, a stock of non-moving articles totalling Rs.3,049,050 had been stored idle in the Katubedda Project Building. Action had not been taken to repair and send to the showrooms these stock of article that remained unsaleable condition.

4.6 Uneconomic Transaction

The following observations are made.

- (a) As the interest for the loan amounting to Rs.200,000,000 obtained by the Board from the Regional Development Bank in the year 2013 had not been paid, the bank had capitalized that loan interest totalling Rs.15,671,233 again as a loan amount. That amount had been settled in the year 2016 and as a result of capitalizing that loan interest, an additional interest of Rs.793,906 had to be paid to the Bank.
- (b) The Light Engineering Training Section at Keselwatta, Panadura had been closed down for about a period of 07 years, whereas sums totalling Rs.1,200,903 had been incurred as security and electricity expenditure during the year 2016.
- (c) While the buildings of the Carpentry Project at Katubedda had remained idle, a building situated at Norice Place, Colombo 10 had been obtained on rent for the office and the stores with effect from 15 May 2013 and a sum of Rs. 14,118,000 and Rs.1,422,318 had been paid as the rental and the renovation activities of that building up to 30 June 2016 respectively. Subsequently, a building situated on Havelock Road, Colombo 05 had been obtained on rent from 01 July 2016 and a sums totaling Rs.4,500,000 had been paid as the rental as at 31 December 2016.

4.7 Identified Losses

As the contributions to the Employees Provident Fund and the Employees Trust Fund had not been duly paid, a sum of Rs.5,374,838 had been paid as the surcharge during the year under review in respect of the preceding year.

4.8 Staff Administration

The following observations are made.

- (a) The approved cadre of the Board stood at 194 comprising 127 members of the permanent cadre and 67 members of the staff on contract basis. There were 43 vacancies in the permanent cadre by the year 2016 and the excess of the employees on contract basis had been 10. The employment of higher percentage of the staff including the major posts on contract basis had adversely affected the performance of the Board.
- (b) Even though 04 posts of Instructors on contract basis had been approved for the Board, another two Instructors had been additionally recruited and without being carried out sufficient works, a sum totaling Rs.2,100,000 had been paid from January to July 2016.

4.9 Procurement and Contract Process

The following observations are made.

- (a) Without being complied with the Guidelines 5.4.4 and 5.4.8 of the Government Procurement Guidelines and the Sections 3.2 and 2.8.1 of the Supplementary No.20 dated 01 January 2011, the contract for the renovation of building in which the Colombo Fort Laksala Head office and the showroom was maintaining had been awarded to a same contractor at Rs.138,743,542 in 04 instances as 04 contracts.
- (b) For the contract which had been abandoned without completing and stated in the Auditor General's Report No.TCM/A/SLHB/1/03/2015 dated 16 May 2017 relating to the renovation of building in which the Colombo Fort Laksala Head office and the showroom was maintaining, sums totalling Rs.30,069,307 had been overpaid to the contractor according to the evaluation report of the Construction Industry Development Authority dated 27 June 2016. The Board had not taken adequate steps to recover the said overpayment and the building was being severely damaging.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

Even though the financial statements should be furnished to the Auditor General within 60 days from the close of the financial year as required by Section 6.5.1 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, the financial statements for the year under review had been presented to Audit on 12 October 2017.

5.2 Corporate Plan

In terms of Section 5.1.3 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, an updated copy of the Corporate Plan approved by the Board of Directors should be furnished to the Line Ministry, Department of Public Enterprises, General Treasury and the Auditor General 15 days before the commencement of the financial year, action had not been taken accordingly.

5.3 Action Plan

The following observations are made.

- (a) Although an Action Plan should be prepared and approval thereon should be obtained as required by the Public Finance Circular No.01/2014 dated 17 February 2014, the Action Plan prepared for the year under review had been approved by the Board of Directors on 27 May 2016.
- (b) In terms of Section 05 (2) of the above circular, the Action Plan should be prepared based on the Corporate Plan, whereas the Action Plan for the year 2016 had not been prepared according to the Corporate Plan.

5.4 Tabling of Annual Reports

Although the Annual Reports together with the audited accounts should be tabled in Parliament in three languages within 150 days from the close of the financial year according to Section 6.5.3 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, action had not been taken to table the Annual Report of the year 2015 even by the end of the year under review.

5.5 Budgetary Control

The following observations are made.

- (a) As variances ranging from 20 per cent to 99 per cent between the budgeted and the actual expenditure were observed relating to 08 Objects, the budget had not been made use of as an effective instrument of management control.
- (b) The Board had spent sums totaling Rs.9,737,921 during the year under review in respect of 08 Objects which had not been estimated in the annual budget.
- (c) The Board had not prepared budget estimates for the capital expenditure during the year under review and payments totalling Rs.7,734,526 had been made for the capital expenditure during the year.

6. 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.

Areas of Systems and Controls

Observations

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|--------------------------|--|
| (a) Accounting | (i) Making journal entries and accounting without proper control and approval, making journal entries without numbers, failure in accounting transactions, failure in preparing trial balance and the financial statements using computerized accounting method. |
| | (ii) Non-maintenance of cash book in written form, failure in recording the relevant ledger account relating to the payments in the cash book and not stating the voucher numbers in consecutive order. |
| (b) Stocks Control | (i) Spending a period of 10 months for the verification of physical stock, not making the relevant adjustments to the stock that should be carried out according to the category of item as at the end of the year. |
| | (ii) Not taking proper action relating to the items that remained unsold over a long period of time out of the items kept at the showrooms for sale and not taking action to modernize such items. |
| (c) Staff Administration | Sixty per cent of the staff of the Board had been recruited on contract basis, action had not been taken to get the staff approved in keeping with the timely requirements. |
| (d) Sales Management | For the handicraft products which had declined in the local market over a long period and for the foreign sales, the Board had paid a minimal attention. |