

Co-operative Surplus Fund - 2017

The audit of financial statements of the Co-operative Surplus Fund for the year ended 31 December 2017 comprising the balance sheet as at 31 December 2017 and the income and expenditure statement and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(3) of the Constitution of the Democratic Socialist Republic of Sri Lanka. My comments and observations which I consider should be published with the Annual Report of the Fund appear in this report.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on the audit conducted 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 paragraph 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 balance sheet, income and expenditure statement and cash flow statement.

2. Financial Statements

2.1 Disclaimer of Opinion

As a result 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 Sri Lanka Public Sector Accounting Standards

The following observations are made.

(a) Sri Lanka Public Sector Accounting Standard 1

- (i) In terms of paragraph 59 of the Standard, particular disclosures should be disclosed on the face of the statement of financial performance. Nevertheless, doubtful debts amounting to Rs.12,652,039 had been entered under other expenses instead of disclosing on the face of the income and expenditure statement.
- (ii) In terms of paragraph 132 of the Standard, measurement bases used in the preparation of financial statements in respect of the carrying amount, depreciation ratios, investments and interests on investments of property, plant and equipment had not been disclosed.

(b) Sri Lanka Public Sector Accounting Standard 2

- (i) The adjustment of Rs.338,399 made to the accumulated surplus relating to the previous year, not affected the cash flow of the year under review had been indicated under financial activities of the cash flow statement.
- (ii) In terms of paragraph 40 of the Standard, receipts of interests on investments amounting to Rs.127,467,899 had been shown in the surplus of income in operating activities without being disclosed separately in the cash flow statement as a cash flow from investments.
- (iii) Even though the net cash flow from investments on fixed deposits during the year under review had been Rs.79,100,000, it had been shown as Rs.109,401,036 in the cash flow statement.
- (iv) The interest on investments capitalized, amounting to Rs.30,432,140 which was not a cash inflow, had been shown as a cash inflow in operating activities of the cash flow statement.

(c) Sri Lanka Public Sector Accounting Standard 7

In terms of paragraph 65 of the Standard, the non-current assets costing Rs.2,720,810 had been fully depreciated as the useful life of non-current assets had not been reviewed annually. However, they were being further used. Accordingly, action had not been taken to revise the estimated error in terms of Sri Lanka Public Sector Accounting Standard 03.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a) Even though the interest income from loans of the co-operative societies relating to the year under review had been Rs.35,469,591, it had been shown as Rs.98,776,480 in the income statement, thus overstating the income of the year and the interest income receivable from loans of co-operative societies by Rs.63,306,889.
- (b) Recovery of loans during the year amounting to Rs.1,690,735 out of the loan balance of co-operative societies of Rs.506,924,925 remained as at the beginning of the year under review had been shown under current liabilities of the balance sheet as at 31 December of the year under review instead of crediting to the relevant Loan Account.
- (c) According to the policy of allocating provision for doubtful debts of the Fund, provisions to be made for performing loan balance of co-operative societies as at 31 December 2017 had been Rs.12,526,022. Nevertheless, provisions made as at that date had been Rs.81,686,262, thus indicating excess provisions of Rs.69,160,240 in accounts.

2.2.3 Unexplained Differences

The following observations are made.

- (a) A difference of Rs.76,776,988 was observed between the loan balance of co-operative societies shown under the sundry debtors balance as at the end of the year under review according to the financial statements and the balance according to the schedule.
- (b) A difference of Rs.184,903 was observed as at 31 December 2017 between the value relating to property, plant and equipment in the balance sheet and value according to schedules.

2.2.4 Suspense Account

A balance of Rs.9,475,735 in the Suspense Account brought forward for over a long period had been included in current liabilities.

2.2.5 Lack of Evidence for Audit

The following evidence indicated against each Item of Accounts had not been made available and as such, they could not be satisfactorily vouched in audit.

	<u>Item of Account</u>	<u>Value</u> <u>Rs.</u>	<u>Evidence not made Available</u>
(i)	Loans receivable from Co-operative Societies	669,008,476	Confirmations of balances
(ii)	Sum receivable from the Co-operative Fund	5,029,486	
(iii)	General Deposit Account	5,500,289	detailed Schedule
(iv)	Secured Creditors on Fixed Deposits	58,918,112	
(v)	Winding up Account(Debit Balance)	2,620,473	A copy of the Winding Up Account prepared
(vi)	Treasury Fund payable	150,000	Confirmation of balances, and detailed Schedules
(vii)	National Trust Fund payable	3,871,256	
(viii)	Adjustment of the Working Account	338,400	Journal Entries

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) A sum of Rs.6,017,550 payable to the Surplus Fund and balances of 05 other payable Liability Accounts totalling Rs.1,020,235 had not been settled over a period of 05 and 06 years respectively.
- (b) Out of the loan amounting to Rs.157,221,330 granted from the year 1992 to the year 2014 to the Sri Lanka Consumer Co-operative Societies Federation Ltd, loan balances of Rs.130,398,674 and outstanding interest thereon amounting to Rs.54,839,436 had been further recoverable. Moreover, out of the loan of Rs.107,721,330 granted in 05 instances, no loan or interest installments whatsoever had been recovered.
- (c) A loan amounting to Rs.100,000,000 had been granted on 26 September 2012 for the construction of a new building complex on behalf of the Kurunegala Ayurvedic Society Ltd,. In terms of the loan agreement, a sum of Rs.18,750,015 was recoverable by 31 December 2017. However, no loan installments whatsoever had been recovered by that date and the outstanding interest thereon as at that date was Rs.3,060,164.
- (d) Out of the loan totalling Rs.184,119,496 granted to 09 co-operative societies within the period from the year 1992 to the year 2014, no money whatsoever had been recovered by 31 December 2017 and the interest recoverable thereon was Rs.45,568,282.
- (e) Out of the loan amounting to Rs.18,249,750 without interests granted in the year 2007 to the Sri Lanka Milk Producers Cooperative Federation Ltd, for the construction of a super milk bar on a land belonging to the Wholesale Co-operative Establishment, a sum of Rs.16,549,750 was recoverable by the end of the year under review. However, the said society is inoperative at present and as such, the recovery of loans had been uncertain.

- (f) A loan amounting to Rs.4,000,000 without interest had been granted on 17 January 2014 for a contract of construction on behalf of the Nikaweratiya Development Co-operative Society Ltd. Even though it had been agreed in terms of the loan agreement that the loan is paid in a lump sum from the income received by completing the contract of construction within 03 months or moneys collected by the Co-operative Society or whichever is received first. However, a loan balance of Rs.1,000,000 was further recoverable as at 31 December 2017.
- (g) Out of the loan amounting to Rs.10,000,000 granted on 05 April 2013 for renovation of a filling station belonging to the Kobeigane Co-operative Society, a sum of Rs.9,166,666 was recoverable by 31 December 2017. However, no money whatsoever had been recovered out of those. The interest to be recovered thereon as at 31 December 2017 was Rs.3,564,453. Further, a loan amounting to Rs.7,000,000 had been again granted on 10 October 2014 for this purpose and this loan amount should be recovered as installments of Rs.150,000 per month. However, a loan balance of Rs.5,527,320 and an interest of Rs.972,855 were recoverable by 31 December 2017.
- (h) Out of loans granted during the period from the year 1990 to the year 2000 to 11 Co-operative societies identified as inoperative societies at present by the Department of Co-operative Development, a loan balance totalling Rs.21,404,358 and interest thereon totalling Rs.8,261,390 was recoverable as at 31 December 2017.
- (i) It had been revealed that Nochchiyagama and Horowpathana Multi-Purpose Co-operative Societies had been winded up and as such, recovery of loan balances of Rs.241,666 and Rs.1,000,000 respectively recoverable as at 31 December 2017 out of loans granted to those two Societies, was uncertain.
- (j) A loan of Rs.14,849,750 granted to the Sri Lanka Milk Producers Co-operative Federation Ltd, which was inoperative by the year under review was being brought forward continuously from the year 2008 to the year under review. Even though it had been mentioned in the reply given to the draft report of the Auditor General of the year 2015 by the Commissioner of Co-operative Development that “the said sum granted under the programme of providing a milk bar for schools free of charge cannot be recovered again and agreements therefor have not been entered into as the said sum is a financial assistance and action is taken to rectify and present the account thereon”, the said loan amount had been shown under sundry debtors in the financial statements of the year 2017.
- (k) A balance of dishonoured cheques valued at Rs.1,721,566 brought forward since the year 1999 had remained under various assets.
- (l) Action had not been taken to settle a sum of Rs.81,871,370 brought forward since the year 2000 as loan interests receivable from the Deputy Secretary to the Treasury, shown under sundry debtors.

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

The following non-compliances were observed.

Reference to Laws, Rules , Regulations etc. -----	Non Compliance -----
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka Financial Regulation 188(2)	Action in terms of Financial Regulations had not been taken in respect of 02 cheques valued at Rs.106,093 deposited but remaining unrealized, relating to the years 2003 and 2014.
(b) Public Finance Circular No.PF/423 dated 22 December 2006 Section 4.3	A statement indicating differences of the Accumulated Fund, along with the performance report for the year under review, had not been furnished to the Auditor General with a copy to the Director General of Public Finance within a period of 02 months after the closure of the year of accounts.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Fund for the year under review was a surplus of Rs.206,780,520 as compared with the corresponding surplus of Rs.103,997,327 for the preceding year, thus indicating an improvement of Rs.102,783,193 in the financial result of the year under review as compared with the preceding year. Even though the expenditure on renovations of the Department had increased by Rs.5,949,591, the increase in the interest income by Rs.107,292,349 had been the main reason for the above improvement.

An analysis of financial results of the year under review and 04 preceding years revealed a continuous increase in the surplus from the year 2013 to the year 2017. Taking into consideration the depreciation on the non-current assets, the contribution which was Rs.28,641,018 in the year 2013 had improved up to Rs.179,709,665 by the year 2017.

4. Operating Review

4.1 Performance

The income of the Fund for the year under review had been Rs.226,244,380 and out of that, a sum of Rs.5,990,957 had been spent for the renovations of the Department deviating from objectives of the Fund. Only a sum of Rs.492,119 had been spent for objectives of the Fund mentioned in Section 44 (iii) of Rules published in the Gazette dated 10 January 1974. Moreover, surplus funds had been invested in fixed deposits and Treasury Bills deviating from functions of the Fund and the value of investments existed as at the end of the year under review had been Rs.1,235,903,403.

4.2 Management Activities

The following observations are made.

- (a) Even though a sum of Rs.773,117,004 had been granted as loans to co-operative societies as at 31 December 2017, taking follow up action in this connection by the Department had been at a weak level. As such, a sum of Rs.506,924,925 representing 66 per cent out of the loan granted and an interest thereon totalling Rs.162,083,550 were recoverable as at 31 December 2017.
- (b) A sum of Rs.56,901,825 spent for winding up activities of Human Resources Co-operative Society from time to time from the year 2007 to the year 2015 in respect of administrative expenses, arbitrator fees, legal expenses, travelling expenses, refreshment, meetings, audit and for the release of deposits of the year 2010 had been entered as receivables under current assets of the balance sheet. Nevertheless, action had not been taken to account the said amount by recognizing the accurate balance based on final reports on accounts of the said co-operative society. Moreover, sums of Rs.1,244,081 and Rs.472,119 had been spent for winding up activities in the years 2016 and 2017 respectively. Even though the registration of the Society had been cancelled in the year 2009, the winding up activities thereof had not been completed even by August 2018.
- (c) A balance more than Rs.4 million had been maintained in the bank current account as at the end of every month except for the month of August of the year under review.
- (d) Provisions for doubtful debts had been made at a rate of 2.5 per cent for the total loan amount without identifying long term loan balances separately out of the loan balance of Rs.506,924,925 of the Co-operative Society remained as at the end of the year under review. Moreover, a policy on making provisions for doubtful debts in respect of other loans amounting to Rs.165,373,998 had not been identified.

4.3 Transactions of Contentious Nature

In terms of Section 44(iii) of the rules of the Co-operative Act, No.5 of 1972, loans from the Co-operative Surplus Fund can be granted only to the Co-operative Societies. Contrary to that, a sum of Rs.75,000,000 had been granted in the year 2013 to the Building Materials Corporation on an agreement entered into by both parties. Out of the said loan, an outstanding loan balance of Rs.62,091,327 and a loan interest of Rs.25,827,742 were recoverable. In terms of the Loan agreement, if it fails to repay the loans, the both parties had agreed to recover them from two mortgage bonds of assets as surety. Even though the period of recovery of loans had elapsed by present, the Fund had not taken action to recover loans from mortgage bonds of assets.

5. Systems and Controls

Deficiencies in systems and controls revealed during the course of audit were brought to the notice of the Commissioner of Co-operative Development and the Registrar of Societies from time to time. Special attention is needed in respect of the following areas of control.

Areas of Systems and Controls

Observations

(a.)	Accounting	Failure to prepare and approve journal entries.
(b.)	Fixed Assets	Failure in maintaining the Registers of Fixed Assets properly.
(c.)	Control of Loans	(i) Failure to examine the financial feasibility of the Co-operative Societies. (ii) Failure in entering into agreements when granting loans and weaknesses in the recovery of loans. (iii) Failure in taking proper follow-up action on loans granted.