Sri Lanka Handicrafts Board - 2018

1.1 Adverse Opinion

The audit of the financial statements of the Sri Lanka Handicrafts Board for the year ended 31 December 2018, comprising the statement of financial position as at 31 December 2018 and the statement of comprehensive income, statement of changes n equity and cash flow statement for the year than ended and notes to the financial statements, including a summary of significant accounting policies 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 provisions of the National Audit Act No.19 of 2018 and the Finance Act No.38 of 1971. My comments and observations which I consider should be reported to Parliament appear in this report.

In my opinion, because of the significance of the matters discussed in the basis for adverse opinion section of my report, the accompanying financial statements do not give a true and fair view of the financial position of the Board as at 31 December 2018 and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Adverse Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAUSs). My responsibilities under these standards are further described in the Auditor's responsibilities for the audit financial statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Board's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Board or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Board's financial reporting process.

As per Sub-Section 16(1) of the National Audit Act No.19 of 2018, the Board is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Board.

1.4 Auditor's responsibility for financial statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Board's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statement or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Board to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following:

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Board and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Board has complied with applicable written law, or other general or special directions issued by the governing body of the Institute.

- Whether the Board has performed according to its powers, functions and duties; and
- Whether the resources of the Board had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Internal Control over the preparation of financial statements

The Board is required to "devise and maintain" a system of internal accounting controls, sufficient to provide reasonable assurance that, transactions are executed in accordance with management's general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards, and to maintain accountability for assets, access to assets is permitted only in accordance with management's general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. Issues with regard to maintenance of key accounting records such as General Ledger, Journal and Journal vouchers, payment vouchers etc. may include under this heading.

1.5.2 Non-compliance with Sri Lanka Accounting Standards

	Audit observation	Management's Comment	Recommendation
(i)	In terms of paragraph 32 of the Sri Lanka Accounting Standard 01 on presentation of financial statements, assets and liabilities or income and expenditure of the Board should not be set off against each other. Nevertheless, a total value of Rs.32,208,102 in 8 receivable accounts and a total value of Rs.32,208,102 in 5 payable accounts as at 31 December 2018 had been set off each other by using long term loan balances settlement ledger account bearing No.70401-00-00 without obtaining Treasury approval.	No direct reply was given for the paragraph.	Action needs to be taken in accordance with the standard.

(ii)	In terms of paragraph 110 of the Sri Lanka Accounting Standard 01, presentation of financial statements, Sri Lanka Accounting Standard 08 requires restatements to correct errors to be made retrospectively need to be adjusted to the opening balance of retained earnings. However, in preparing the statement of change in equity as at 31 December 2018 by the Board, the total value of revenue reserve amounting to Rs.178,017,763 had been adjusted in a separate column in the statement of changes in equity as a revenue reserve without being adjusted to the opening balance of retained earnings account.	No direct reply was given for the paragraph.	Action needs to be taken in accordance with the standard.
(iii)	In terms of paragraph 110 of the above standard, in making retrospective adjustment in terms of Sri Lanka Accounting Standard 08 to effect changes in accounting policies and to correct error should be disclosed separately in the statement of changes in equity. Without doing so revenue reserves totalling Rs.139,836,768 as at 31 December 2018 was stated as adjustments and prepared the statement of changes in equity.	No direct reply was given for the paragraph.	Action needs to be taken in accordance with the standard.
(b)	**Sri Lanka Accounting Standard 02** **--------------------------------------**		
	In terms of paragraph 34 of the Sri Lanka Accounting Standard 02 on inventories the loss of Rs.93,841,464 identified related to stock had not been disclosed in the financial statements in terms of paragraph 36(a) of the standard.	No direct reply was given for the paragraph.	Action needs to be taken in accordance with the standard.

	Audit observation	Management's Comment	Recommendation
(c)	**Sri Lanka Accounting Standard 07**		
	In terms of paragraph 16(b) of the Sri Lanka Accounting Standard 7, money received from sale of fixed assets should be disclosed under investing activities in the cash flow statement but it had been included in the pre-tax profit and prepared the cash flow statement.	No direct reply was given for the paragraph.	Action needs to be taken in accordance with the standard.

1.5.3 Accounting Deficiencies

	Audit observation	Management's Comment	Recommendation
(a)	By using journal entries to the cash book maintained in the SAP Computerised accounting system, transactions had been accounted during the year under review by the Board. Accordingly, transactions relating to debits or credits totalling Rs.7,155,350 had been accounted by using 24 journal entries in the cash book maintained for the current account No.7264. Transactions relating to debits or credits totalling Rs.32,221,464 had been accounted by using 40 journal entries in the cash book maintained for the current account No.6526.	Steps have been taken not to recur such errors in future.	Action according to the reply is appropriate. Issues in the SAP Software need to be settled.
(b)	Even though, the total value of provision for gratuity as at 31 December 2018, according to the schedule along with the Financial Statements amounted to Rs.43,633,230, the value of provision for gratuity as at that dated as per the ledger amounted to Rs.43,319,441, thus under stating the provision for gratuity as per the ledger by Rs.313,789.	The gratuity schedule is corrected as Rs.43,316,441 and it has been presented to audit. It is accepted that there was a difference of Rs.3,000 when comparing with the ledger.	Reply is not correct. In de briefing the reply it was accepted that the reply it wrong. It needs to be rectified.

(c)	As an erroneous command given to the SAP Computer Software for a total value of Rs.5,508,020 which was the cost of goods sold on special orders as at 31 December 2018, such value had been debited to the sales account on special orders. As the journal entry passed to rectify that error was also an erroneous journal entry, a sum of Rs.5,508,020 to be debited to the cost of goods sold account had been debited to the special orders stores stock account. As a result of this erroneous journal entry, the cost of goods sold account as at 31 December 2018 had been understated and the special orders stores stock account had been overstated in the financial statements by that amount.	Observations in the para were accepted.	Needs to be rectified.
(d)	According to the statement of arrears of tax of the Department of Inland Revenue as at 31 December 2018, the payable VAT balance amounted to Rs.716,749, whereas a sum of Rs.5,664,297 had been posted to the financial statements as taxes payable thus the balance of the payable VAT account overstated by Rs.4,947,548. According to the above arrears of tax statement, the penalty payable in respect of arrears of VAT totalled Rs.1,877,463 but it had not been brought to account in the year under review.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(e)	According to the statement of arrears of taxes of the Department of Inland Revenue as at 31 December 2018 arrears of Nation Building Tax payable amounted to Rs.5,383,496 but it had been posted as Rs.28,562,386 and as	Agreed to rectify the accounts.	It is appropriate to act according to the reply.

	such the Nation Building Tax payable had been overstated in the financial statements by Rs.23,178,890. According to the above statement of arrears of taxes, the payable penalties in respect of arrears of NBT amounted to Rs.5,365,512 but it had not been brought to accounts in the year under review.		
(f)	According to the statement of arrears of taxes as at 31 December 2018 of the Department of Inland Revenue, the balance of Economic Services Tax (ESC) payable amounted to Rs.2,926,736 whereas it was posted as Rs.23,332,443 to the financial statements and as such the value of ESC payable had been overstated by Rs.20,405,707 in the financial statements. As per the above arrears of taxes statement, penalties payable on the arrears of ESC amounted to Rs.1,546,935 but it had not been brought to accounts.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(g)	According to the statement of arrears of taxes of the Department of Inland Revenue as at 31 December 2018, the balance of outstanding income tax amounted to Rs.22,387,108 and the arrears of surcharges on income tax amounted to Rs.590,768. The Board had not computed and accounted income tax and surcharges thereon in the prior years. The fine payable on these outstanding income tax and surcharges amounted to Rs.2,481,404 but it had also not been brought to account as payables.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.

(h)	In computing depreciation in the year 2018 depreciation on land and buildings totalling Rs.48,984,819 had not been computed and as such depreciation for the year under review totalling Rs.1,224,620 had been under accounted.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(i)	In the comparison of ledger account balances, accounts schedules and financial statements a total sum of Rs.718,258 relating to 2 ledger accounts had been overstated in the financial statements.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(j)	Unsettled advances totalling Rs.2,225,750 given to 5 purchasing centres for the payment suppliers of goods as at 31 December 2018 had been deducted from the total creditors when financial statements were prepared and as such creditors in the financial statements had been understated by that amount.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(k)	Due to dissidence with the National Audit Office to issue invoices for audit fees for the accounting years 2015, 2016 and 2017 invoices for audit fees could not be issued. Provision for audit fees for the year 2017 amounting to Rs.1,568,717 had not been made in the accounts.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.
(l)	According to the financial statements, the value of stock in 14 showrooms and wholesale stores as at 31 December 2018 totalled Rs.434,008,464 but according to the board of survey reports of those showrooms and wholesale stores the value stock totalled Rs.433,284,445.	Agreed to rectify the accounts.	It is appropriate to act according to the reply.

	Therefore, the value of stock in the financial statements had been overstated by Rs.724,019.		
(m)	Stock shortages, excesses, stock losses, damages and destructions revealed at the annual Board of Surveys had not been identified and corrected the accounts and they have been posted to a suspense account instead. There was a debit balance of Rs.93,841,464 in that suspense account as at 31 December 2018. As this debit balance had been written off against the credit balance of the prior year adjustment account, the debit balance of suspense account and the credit balance of prior year adjustment account had been understated by Rs.93,841,464 in the financial statements.	Only a matter clarification is given by the reply.	It is a journal entry accounted without prior approval. Ledger accounts needs to be readjusted and the suspense account needs to be cleared after being verified.
(n)	A stock balance of Rs.38,441,797 in 12 stock ledger accounts of the Board as at 31 December 2018 had been written off by using a journal entry in debiting prior year adjustment account without a written approval. As a result, the balance of the stock account in the financial statements as at 31 December 2018 and the credit balance of the prior year adjustment account had been understated and prepared the financial statements accordingly.	No direct reply was given therefore. Stock variances relating to each year since 2011 have been identified by physical verifications. Accordingly. the stock adjustments relating to prior years had not been adjusted in the relevant years and brought forward. The effect thereon had been eliminated and to identify the actual stock balance it had been adjusted as the revenue reserve in the statement of changes in equity.	This journal entry has been accounted without prior approval, adjustments to be made to the ledger account again.

1.5.4 Unreconciled Control Accounts or Reports

Item	Value as per financial statements	Value as per subsidiary records	Difference	Management's Comment	Recommendation
	Rs.	Rs.	Rs.		
Bank Accounts	3,428,033	5,138,010	1,709,977	No reply up to the date of this report.	Steps need to be taken to correct the control accounts.

1.5.5 Lack of documentary evidence for audit

	Item	Amount	Audit evidence not made available	Management's Comment	Recommendation
(a)	Finished stock of second grade	7,266,688	Board of survey reports.	It was decided to take future action after being verified.	Non-presented audit evidence needs to be presented.
(b)	Sale of credit cards	27,659,287	Particulars of cash recoveries	Due to lack of staff reconciliation reports could not be presented.	Non-presented audit evidence needs to be presented.
(c)	Unsettled Advances	10,672,211	Sufficient evidence to confirm the balance.	No direct reply was given.	Non-presented audit evidence needs to be presented.
(d)	Income Tax	5,149,100	Tax computations and tax payment files.	Under the tax rate for companies, 25 per cent tax is provided.	Non-presented audit evidence needs to be presented.
(e)	Accounts Payable	41,217,749	Creditors balance confirmations, creditors files, creditors schedules and creditors age analysis.	Accepted the observations stated in the paragraph	Non-presented audit evidence needs to be presented.

(f)	Land and Buildings	644,834,974	Register of fixed assets.	Accepted the observations stated in the paragraph	Non-presented audit evidence needs to be presented.
(g)	Journal entries prepared by SAP Computer Programme	-	Journal entries with written evidence	As these journal entries are generated by the computer system itself, copies could not be obtained.	Non-presented audit evidence needs to be presented.

1.6 Accounts Receivable and Payable

1.6.1 Accounts Payable

Audit observation	Management's Comment	Recommendation
Out of the trade creditors balance of Rs.394,770,365 as at 31 December 2018 balances totalling Rs.191,110,774, Rs.63,377,660, Rs.39,641,605 and Rs.100,639,816 had remained outstanding for less than 01 year, 01 to 02 years, 02 to 03 years and over 03 years respectively. Action had not been taken to settle these creditors balances.	Steps had been taken to pay a sum of Rs.160 million from the creditors during the year 2019.	Action needs to be taken to settle the balance liabilities and make necessary adjustments in the accounts.

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

	Reference to Laws, Rules, Regulations etc.	Non-compliance	Management's Comment	Recommendation
(a)	Section 21(1) of Chapter III of the Value Added Tax Act No.14 of 2002.	Even though, tax returns on VAT for every tax period need to be presented to the Department of Inland Revenue, taxes of Rs.465,750 recovered on super brand ground rent income during the year 2018 and tax returns had not been remitted to the Department of Inland Revenue.	No reply up to the date of this report.	Action needs to be taken in terms of the Act.

(b)	Public Enterprises Circular No.PED/12 of 02 June 2003.			
	(i) Section 5.1.3	The copies of the tentative corporate plan, approved by the Board of Directors along with the budget needs to be presented to the Department of Public Enterprises of the Treasury, Line Ministry and the Auditor General before 15 day of the begin the financial year. However the corporate plan for the period 2018-2022 had been approved by the Board of Directors and presented to audit on 18 September 2018.	No reply up to the date of this report.	Action needs to be taken in terms of the circular.
	(ii) Section 4.2.6	Performance reports had not prepared and presented to relevant authorities before 30 days of the closure of quarter.	No reply up to the date of this report.	Action needs to be taken in terms of the circular.
(c)	Paragraphs 2.2 and 2.3 of the Public Enterprises Circular No.03/ PED of 07 December 2018.	Without taking action to present the draft annual report and the financial statements within 60 days a total sum of Rs.2,160,000 had been brought to account as incentives payable.	No reply up to the date of this report.	Action needs to be taken in terms of the circular.

2. Financial Review

2.1 Financial Results

Operating result of the Board for the year under review had been a profit of Rs.16,441,514 as compared with the profit of Rs.24,862,164 for the preceding year. Accordingly, a deterioration of Rs.8,420,650 in the financial results was observed. Decrease of Revenue by Rs.18,142,523, non-receipt of government grants in the year 2018 and making provision for taxation amounting to Rs.5,149,100 had attributed to this deterioration.

3. Operating Review

3.1 Uneconomic Transactions

Audit observation	Management's Comment	Recommendation
In order to modification of the Laksala Building at Fort, the Head Office and the divisions of the Board established therein had been removed and the building facilities	The present management had taken action to hand over the rented building back.	Action needs to be taken to use the lands and buildings belongs to the Board and to minimise the rent expenses.

had been obtained to operate those division on rent basis. A sum of Rs.38,340,318 had been paid as at 31 December 2018 for the repairs and building rent of those rented buildings.

3.2 Identified Losses

Audit observation	Management's Comment	Recommendation
A total sum of Rs.6,282,072 had been paid to the Employees Provident Fund during the year under review as arrears of EPF and surcharges thereon from January 2000 to June 2016.	Accept the observations in the paragraph	Without paying fines and interest, action needs to be taken to pay EPF on specific dates.

3.3 Management Inefficiencies

	Audit observation	Management's Comment	Recommendation
(a)	The 'Ape Gama' premises belonged to the Board, had been entrusted to the Ministry of Education by the gazette extra-ordinary No.1933/13 of 21 September 2015. Despite, such physical assets had been so entrusted, the trial balance for the year 2018 had been prepared and presented to audit by including the accounts balances of assets and liabilities consisting debits or credits totalling Rs.43,829,223.	After the receipt of money thereon from the Treasury, action will be taken to hand over the assets and liabilities to the ministry.	Ledger accounts balances, related to the 'Ape Gama' premises needs to be eliminated from the trial balance of the Board.
(b)	SAP computerised accounting software is used for keeping accounts by the Board, but an appropriate training to use this software had not been given to the staff. Even though, backups are kept for the protection of the system, there was no ability to re-enter such data into the system when required. As the service agreement entered into with the mother company of the SAP Software is not updated, there may be a great risk in using the software.	No reply up to the date of this report.	SAP Computer Software used by the Board needs to be improved on the periodical requirements.

(c)	The Board of Directors had instructed to revise the budget prepared for the year 2018 and it had been revised and implemented accordingly but the approval for the revised budget was not made available to audit.	No separate approval is noted and the revised budget had been implemented as per instructions given	Approval of the Board of Directors needs to be obtained for the revised budget.
(d)	For the modification of the Fort Laksala Building which is declared as an Archaeological secured monument, the written approval of the Department of Archaeology had not been obtained by the Handicraft Board. As the modification work commenced without such approval was halted halfway, the building is being dilapidated.	Accepted the observations in the Para.	Laksala Building at Fort needs to be conservated and protected.
(e)	As the rent for the Race course showroom had not been paid to the Urban Development Board, the showroom had been sealed on 18 September 2018 and a sum of Rs.1,113,613 had been spent for the development of the showroom in the year 2013. Even though, it was informed in writing that legal action will be taken as rent is not paid, the Board had not paid attention thereon.	No complete reply was given but just explained the issues.	As the Urban Development Authority had informed that legal action will be taken, necessary action needs to be taken in this connection.
(f)	A stock of goods totalling Rs.6,770,488 had been removed from the showroom sales during the period 2015 to 2018. The total value of goods so removed only in the year 2018 amounted to Rs.2,060,754. Steps had not been taken to resolve such stock issues and to minimise such non-saleable stock.	Action will be taken to market those stock soon in future after being sought.	Steps need to be taken to minimise the goods removed from the showroom stock of sales and the damaged goods and stocks stated in the paragraph.

3.4 Operating Inefficiencies

	Audit observation	Management's Comment	Recommendation
(a)	Even though, the anticipated corporate sales during the year under review amounted to Rs.50,000,000, the actual sales was Rs.14,960. Therefore, the progress of reaching such sales target was only 0-03 per cent.	No reply up to the date of this report.	Management needs to reach the designed targets.
(b)	Registration of 250 new suppliers for the increase of sales and to begin 25 crafts villages for the direct purchase of handicrafts products had been targeted but 97 new suppliers had been registered during the year under review and 05 crafts villages had been commenced. Accordingly, the physical progress of reaching targets had been 39 per cent and 20 per cent respectively.	No reply up to the date of this report.	Management needs to reach the designed targets.
(c)	Even though, it was planned to open 02 new showrooms during the year under review, it was unable to open any new showrooms.	No reply up to the date of this report.	Plans need to be designed by identifying periodical requirements and financial strength and action needs to taken as per designed plans.
(d)	Twenty three objectives designed to be commenced during the period from January to September of the year under review by the Board had not been implemented during that period.	No reply up to the date of this report.	Plans need to be designed by identifying periodical requirements and financial strength and action needs to taken as per designed plans.

4. Accountability and Good Governance

4.1 Presentation of Financial Statements

Audit observation	Management's Comment	Recommendation
In terms of section 16(2) of Part III of the National Audit Act No.19 of 2018 and section 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the financial statements and the draft annual report need to be presented to the Auditor General within 60 days after the financial year. However, the financial statements of the year 2018 had been presented to audit on 17 May 2019.	No reply up to the date of this report.	Financial Statements need to be presented in terms of the Act and the circular on specific date.

4.2 Internal Audit

Audit observation	Management's Comment	Recommendation
During the year under review, 20 internal audit queries had been issued but the Board had replied to only 3 audit queries. Accordingly, it was observed that the top management had not made use of the internal audit division for the management and control purposes effectively.	No reply up to the date of this report.	Management needs to take action to find the internal audit queries and to correct the issues mentioned thereon.