

Kantale Sugar Industries Limited - 2018

1.1 Disclaimer of Opinion

The audit of financial statements of the Kantale Sugar Industries Limited (“Company”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of income, statement of changes in equity and the cash flow statement for the year then 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 Section 12 of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be tabled in Parliament appear in this report.

Because of the significance of the matters described in the Section Basis for disclaimer of opinion 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 the financial statement of the Company.

1.2 Basis for Disclaimer of Opinion

My opinion is disclaimed based on the matters described in paragraph 1.5 of this report.

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 Company’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 intends to liquidate the Council or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

As per Sub-section 16 (1) of the National Audit Act No. 19 of 2018, the Company 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 Company.

1.4 Scope of Audit (Auditor's Responsibilities on the Financial Statements)

My responsibility is to conduct an audit of the Company's financial statements in accordance with Sri Lanka Auditing Standards and to issue an auditor's report. However because of the matters described in the Basis for Disclaimer of Opinion section, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.5 Financial Statements

1.5.1 Non-compliances with Sri Lanka Accounting Standards

Non-compliance	Comment of the Management	Recommendation
In terms of Section 09 of the Sri Lanka Accounting Standard 02, the final stock should be measured on the cost or the net realization value, whichever was less. However, the stocks remained in the stores for 20 years without being used had been computed based on the cost, and shown as Rs. 47,440,818 in the financial statements.	The Company was wound up on 1994.03.31. The Chairman appointed newly in the year 1997, conducted a stock survey on all the stores & buildings before being sealed and closed them. No stock surveys had been conducted thereafter, and obsolete stocks had not been written off. As such, the value of this stock remained unchanged.	A survey should be conducted on the items existing in the stores of the Company thereby showing the accurate stock value in the financial statements.

1.5.2 Accounting Deficiencies

Non-compliance	Comment of the Management	Recommendation																																				
(a) The overtime payable for the year under review totaled Rs. 1,987,206 for the year under review but the said amount had been understated by Rs. 59,954 in the statement of financial position thus showing the sum of Rs. 1,927,252.	<p>The overtime payable for the year 2018 is given below.</p> <table border="1"> <tbody> <tr> <td>01</td> <td>169,376</td> <td>07</td> <td>153,123</td> </tr> <tr> <td>02</td> <td>177,216</td> <td>08</td> <td>149,871</td> </tr> <tr> <td>03</td> <td>176,302</td> <td>09</td> <td>117,375</td> </tr> <tr> <td>04</td> <td>219,646</td> <td>10</td> <td>157,229</td> </tr> <tr> <td>05</td> <td>148,648</td> <td>11</td> <td>141,298</td> </tr> <tr> <td>06</td> <td>146,957</td> <td>12</td> <td>165,133</td> </tr> <tr> <td colspan="2">Total</td> <td></td> <td>1,922,154</td> </tr> <tr> <td colspan="2">Paid by petty cash H/O</td> <td></td> <td>5,098</td> </tr> <tr> <td colspan="2"></td> <td></td> <td><u>1,927,252</u></td> </tr> </tbody> </table>	01	169,376	07	153,123	02	177,216	08	149,871	03	176,302	09	117,375	04	219,646	10	157,229	05	148,648	11	141,298	06	146,957	12	165,133	Total			1,922,154	Paid by petty cash H/O			5,098				<u>1,927,252</u>	The overtime payable should be accurately shown in the financial statements.
01	169,376	07	153,123																																			
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As such, it is informed that the value shown in the financial statement is correct.

- (b) The balance of Rs. 840,774 shown under work in progress with respect to the period from 2005 up to the end of the year under review, had not been identified and adjusted to the relevant accounts. As the Kantale Sugar Industries Limited had been closed with effect from 1994.04.01, information as to whether the building the constructions of which had not progressed thereafter despite being shown under the work in progress to the value of Rs. 840,774, had been completed, could not be obtained from the civil engineering division. The works in progress continuing to exist in the accounts since the year 2005, should be accurately brought to accounts.

1.5.3 Non-reconciled Reports

Item	Value as per Financial Statements	Value as per the Corresponding Reports	Difference	Comment of the Management	Recommendation
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	Rs.	Rs. Million	Rs.		
Property, Plant and Equipment	73,849,491	540	466,150,509	The them Ministry had assessed the assets with the Government Valuation Department in 2007 and 2017. However, our Company had not been informed on the value thereof.	The assets belonging to the Company should be assessed and brought to the accounts under the fair value.

1.5.4 Lack of Documentary Evidence for Audit

Non-compliance	Comment of the Management	Recommendation
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The Audit had not been provided with letters of confirmation of balances in order to verify the trade and other payable balances totaling Rs. 16,598,342 existed as at the end of the year under review.	When trade and other payable balances totaling Rs. 16,598,342 had been sold to the Industrial Development Board, the Company had been given a sum of Rs. 16,598,342 in excess. Iron had not been issued to that institution again in favor of the said amount. As such, our Company should pay that amount.	The audit evidence required to verify the balance shown in the accounts, should be made available to the Audit.

1.6 Accounts Receivable and Payable

1.6.1 Monies Receivable

Non-compliance	Comment of the Management	Recommendation
Action had not been taken for the recovery of amounts receivable and paid in advance totalling Rs. 42,183,209 continuing to exist since the year 1993.	A report has been furnished relating to the sum of Rs. 14,036,375 included in the said sum of Rs. 42,183,209 and receivable from Mr. Sumanasekara, a previous investor of the Kantale Sugar Industries Limited. This was mentioned in the Case, No. 3805 filed by the Kantale Sugar Industries Limited against Mr. Sumanasekara at the District Court of Colombo for the recovery of those monies. However, it has been informed by the Attorney General's Department that no further action could be taken as hearing had taken 20 years. Hence, recovery of those monies failed.	Action should be taken for the immediate recovery of monies receivable.

1.6.2 Monies Payable

Non-compliance	Comment of the Management	Recommendation
Action had not been taken to settle the sum of Rs. 76,352,246 shown as being payable to the Ceylon Electricity Board since the year 2010.	Instructions had been sought by the Ceylon Electricity Board from the Attorney General to case a file against the Kantale Sugar Industries Limited for the recovery of Rs. 76,353,246 payable to the CEB by the Company. As the dispute was among two Government institutions, instructions were given that a decision should be taken through dialogue.	The sum of Rs. 44,839,081 receivable from the Sri Lanka Army included in the due payable to the Ceylon Electricity Board since the year 2010, should be recovered thereby settling the total balance in full.

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

Reference to Laws, Rules, and Regulations, etc.	Non-compliance	Comment of the Management	Recommendation
Financial Regulation of the Democratic Socialist Republic of Sri Lanka. Financial Regulation 756	A physical verification had not been conducted on stocks and fixed assets after the year 1997.	The Company was wound up on 1994.03.31. The Chairman appointed newly in the year 1997, conducted a stock survey on all the stores & buildings before being sealed and closed stores. No stock surveys had been conducted annually thereafter. Assets had been assessed in the years 2007 and 2017 by the Government Valuation Department and the reports had been sent to the Ministry.	Physical stock surveys should be conducted in accordance with the Financial Regulations thereby taking action to verify the accuracy of stock thus making necessary adjustments.

2. Financial Review

2.1 Financial Results

The operating result of the year under review had been a deficit of Rs. 13,192,264 as compared with the corresponding deficit of Rs. 4,769,102 for the preceding year thus observing an increase of Rs. 8,423,162 in the deficit of the financial result. This deficit is mainly attributable to the decrease in Treasury grants by Rs. 11,852,097.

3. Operating Review

3.1 Management Inefficiencies

Non-compliance	Comment of the Management	Recommendation
(a) Under the restructuring programme to increase the local sugar production by reopening	Not replied.	The Company should be immediately restructured and the

Kantale Sugar Industries Limited that had remained closed over a period of 25 years without being engaged in any production process, the investors should have invested a sum of US \$ 100 million thereby implementing the said project within a period of 05 years. Nevertheless, no such an investment had been made even up to 31 January 2020 whilst being observed that the Government of Sri Lanka had been deprived of the ownership of buildings belonging to the Company including all the machinery. It was further observed that a sum totaling Rs. 40.392 million had been paid during 2015 - 2018 as salaries and allowances to the employees of the Company that had not been engaged in any production process.

production process should be commenced in order to increase the local sugar production.

- (b) An open tender procedure had not been followed to select an investor for the restructuring of Kantale Sugar Industries Limited; instead, the evaluation of investments had been done based on 02 applications received directly by the Ministry of Lands and the Board of Investment. It was observed in audit that invitation for proposals for investment had not been done with adequate transparency. Furthermore, the Audit was informed that no document whatsoever had existed in the possession of the Ministry of Lands.

The Board of Investment :
When the Cabinet Paper was presented by the Minister of Lands on 14 February 2015 relating to the restructuring of Kantale Sugar Industries Limited, The Board of Investment had no pre-awareness thereof, nor had any connection thereto. Nevertheless, it was stated that the relevant project be registered as a BOI project.

The Ministry of Lands :
Due to scope of the Ministry being revised, all the files relating to the Kantale Sugar Industries Limited, had been handed over to the Ministry of Primary Industries on 2018.04.24. Hence, it was informed

Action should be taken to follow an official tender procedure thus selecting a suitable investor with transparency.

that the query could not be replied.

- (c) It was observed that the shareholder agreement for restructuring Kantale Sugar Industries Limited had been prepared by the then legal consultant of the Ministry of Finance by disregarding the clearances given by the Attorney General's Department on 01 August 2016. Moreover, without further studying the technical and commercial aspects relating to the clearance given on 01 August 2016, it was informed that, by presenting a clearance on 04 August 2016, there was no legal objection on the implementation of that project.

Ministry of Finance :
It appears in accordance with the file that a reply had been sent to the Attorney General's Department by the said legal consultant in response to the letter of the said Department, dated 2016.08.01 including their observations, and Secretary to the Ministry or any other officer had not been apprised of the matters contained in that reply letter. It further appears that the observations of the Attorney General had not been included in the shareholder agreement as well. Moreover, the observations of the Attorney General dated 2016.08.01 had not been brought to the notice of the Secretary to the Ministry of Finance at the time of signing the final agreement.

When observations were presented by the legal consultant of the Ministry of Finance relating to the clearances of the Attorney General, the Secretary to the Ministry of Finance should have been informed in that connection thus obtaining approval thereon. Before signing the final shareholder agreement, the conditions set out therein should have been examined.

In examining the said agreement, it is the responsibility of the Attorney General to check for its legality. For that, the availability of relevant Cabinet Papers and approval was checked while examining as to whether the agreement infringed the laws in Sri Lanka. In doing so, the stance of this Department on the said agreement was expressed through the letter, dated 2016.08.01. Although opinions were expressed as to how the Section 7.1.0 of the said agreement be drafted, it was not a conclusion made on the legality of the agreement. It was later stated through the letter, dated 2016.08.04 that there was no legal objection on the agreement, and no opinion was made on the technical and commercial aspects of the

agreement, while assuming that those aspects had been taken into consideration by the Ministry of Finance. As such, it is implied that the Attorney General does not take responsibility on the technical and commercial aspects of this agreement.

- (d) It was observed that the Secretary of the Treasury or other officer had not been informed on the matters mentioned in the letter sent by the former legal consultant of the Ministry of Finance to the Attorney General's Department in response to the letter sent by the Attorney General's Department to the Ministry of Finance including the observations. It was also observed that, even at the time of signing the final agreement, observations of the Attorney General, dated 2016.08.01 had not come under the attention of the Secretary of the Treasury.
- Not replied.
- The legal consultant should have apprised the relevant parties of the conditions set out in the agreement prior to signing the final shareholder agreement.
- (e) Contrary to the condition that the investor should bring the machinery to the factory, it was observed that the former legal consultant of the Ministry of Finance had included a condition to the signed agreement enabling the investor to use the existing machinery. The Audit also observed that the final drafts sent to the Attorney General seeking clearance for that condition, had not been included in the shareholder agreement.
- Ministry of Finance :
Despite being clearly stated in the Cabinet Paper presented to the Cabinet relating to this investment that the machinery required for the factory should be brought by the investor, the said officer is observed to have revised the signed and final agreement allowing the investor to use the existing machinery in the factory. However, it is further stated that the said officer no more officiates at the Department of Legal Affairs in the Ministry of Finance at present.
- An investigation should be launched on the legal consultant who had included a condition which had not been in the draft agreement sent to the Attorney General's Department for clearance, to the final and signed agreement.

- (f) It was observed in audit that the shareholder agreement that had been entered into, had caused the disposal process of machinery including the buildings of the Kantale Sugar Industries Limited, to end up in disruption.
- Board of Investment :
The relevant institutions should provide further explanations in accordance with the decision taken at the Cabinet Committee on Economic Management (CCEM) held on 2017.03.15
- As a condition stated in the Cabinet Paper had not been included in the signed agreement, the disposal process could not be done. This should be identified and suitable action should be taken in that regard.
- (g) It was observed that the signed agreement had been prepared by the former legal consultant of the Ministry of Finance in a manner which is favorable to the investor and unfavorable to the Government of Sri Lanka. It was further observed that the decision of the Singapore International Arbitration Centre wanted the Government of Sri Lanka to pay sums of Singapore Dollar 894,516.83 and Rs. 211,913.93 as compensation to the investor whilst the project cost had been increased by 15 per cent.
- An arbitration case had been filed by the investor at the Singapore International Arbitration Centre demanding that machinery of the factory be allowed to be used by him. The Attorney General's Department represented the Government of Sri Lanka for that case. As per the instructions given by the Attorney General, Mr. I. H. K. Mahanama was nominated as the main witness of the Government in March 2018, and he placed his signature on the documents relating to the said case. The said documents of evidence had been filed to be used in the arbitration case as well. In this backdrop, the said nominee was apprehended in May 2018 while attempting to take bribes from the investor. Allowing him, as a Government witness, to take part in the arbitration case when it was heard, was refused by the Attorney General's Department. Accordingly, it was decided in the case that the machinery of the sugar factory should be provided for the investor. The arbitration board, however, refused to provide the investor with the sum of US \$ 100 million that the investor demanded
- The compensation to be paid due to the inclusion of conditions that were unfavorable to the Government of Sri Lanka, should be recovered from the parties responsible.

as compensation in regard of the loss sustained by him. The Ministry of Finance and the Attorney General's Department made explanations in that connection before the arbitration board.

Attorney General's Department :

The dispute occurred with the said agreement was settled through an international arbitration. The decisions of arbitration can not be appealed against, unlike the court decisions. As such, there is no legal possibility to lodge an appeal against this arbitration.

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| <p>(h) As the Cabinet Memorandum had been presented to the Parliament without proper coordination between the Ministry of Finance, Ministry of Land Reforms, and Board of Investment being the institutions responsible for restructuring Kantale Sugar Industries Limited, the Company the sugar production process of which had been halted in the year 1994, could not be vested with an investor even up to the date of audit. Hence, the production process could not be commenced.</p> | <p>Taking decisions relating to the restructuring of Kantale Sugar Industries Limited, is beyond our scope, and those were the decisions taken by the Ministry. The information required in that connection do not exist in our possession.</p> | <p>Action should be taken for the immediate completion of restructuring the Kantale Sugar Industries Limited.</p> |
| <p>(i) Ninety six persons illegally occupy the official residences of the Company, but the management had not taken action to evict them from the official quarters.</p> | <p>It had been decided by the former Minister of Land, Mr. M. K. D. S. Gunawardena to evict the 96 illegal occupants from the official quarters after providing them with land plots from the Company premises for constructing houses. However, this was delayed due to the demise of the Minister.</p> | <p>The management should take measures to evict the illegal occupants thereby securing the official residences.</p> |
| <p>(j) It was observed in audit that an expensive chain, named "Jungle</p> | <p>Not replied.</p> | <p>Necessary action should be taken to</p> |

- Cleaning” used to clear the cultivated lands of the Company, had been engulfed in wilderness.
- (k) It was observed in audit that the tank farm constructed for cooling the hot water of the factory and the water filtering system had become a breeding ground for mosquitoes due to accumulation of rain water. Not replied. safeguard such assets of the Company before being damaged. Action should be taken to avoid accumulation of rain water thus keeping the environment clean.
- (l) The Audit observed that vehicles belonging to the Company had remained parked while falling into decay without security and being sheltered at the premises over a period of about 25 years. The chassis numbers of the vehicles had been removed in view of the tender procedure. However, the tender procedure had become cancelled since the ownership of the vehicles including the machinery had become under the ownership of the investor thus observing that the identity of vehicles could not be verified owing to the removal of the chassis numbers. Not replied. Action should be taken for the safe custody of those assets until being disposed of. The disposal process should be expedited.
- (m) The Kantale Sugar Industries Limited with the annual production capacity of 16,320 metric tons of sugar, 9,000 metric tons of molasses , and 3.9 million liters of maturate spirit, had temporarily been taken over by the Government on 01 September 1993. However, the production of sugar had discontinued from April 1994 and as such, thousands of people in the area Due to lapse of a period of 25 years, the machinery and vehicles are undergoing decay. The Ministry had decided on several occasions to auction those machinery and vehicles, but there doesn’t exist a methodology in that connection so far. A heavy cost should be incurred for safely storing a large stock of items. The responsible institutions should take measures to restructure this Company remaining closed since the year 1994 and vest in a suitable investor whilst disposing the unusable assets.

had lost job opportunities directly and indirectly. Moreover, the machinery and vehicles parked at the premises of the Company of which the value had been assessed to be Rs. 125 million in the year 1991 by the Department of Valuation, had become unusable due to lack of security and shelter. The value of vehicles had declined by Rs. 12,463,500 during the 05 preceding years in accordance with the valuation reports presented by the Department of Valuation in the years of 2012 and 2017; nevertheless, no action had been taken for the disposal of unusable machinery and vehicles.

- (n) An extent of 8596 hectares of land is owned by the Company. The sugar factory and the complex of official residences are located over an area of 164 hectares. An area of 4800 hectares had been made use of for sugarcane cultivation during the heyday of the sugar factory, but at present sugarcane is not cultivated anywhere. The lands have been used by the encroachers for paddy and other cultivations though, no action has been taken by the management for the eviction of encroachers.
- 2 ³/₄ acres of land had been provided only for 647 sugarcane land allottees whereas 500 acres had been given to the Sugarcane Research Institute for cultivation. That institution cultivates sugarcane over an area of about 110 acres whilst producing sugarcane seeds. MG Sugars Lanka Private Limited had been provided with 500 acres through agreements (for sugarcane seeds and constructing factories). An acre of land is given to the cultivators at Rs. 1000 for paddy cultivation during Maha Season. At the end of the Season, they abandon those lands, and this is not considered an act of encroachment.
- As the lands belonging to the Company have not been in use for any cultivation over many years, it is likely for the lands to be encroached. As such, necessary action should be taken to avoid such incidents.
- (o) The group of buildings at the premises of the factory valued at Rs. 133,150,000 by the Department of Valuation for the year 2017 comprising the head
- Funds are not allocated by the Ministry for the maintenance of buildings of the Company. There are no employees for cleaning them. Although the Ministry of
- Action should be taken immediately to dispose of unusable assets belonging to the factory whilst

office building, stores, laboratories, sugar storages, security building, and official quarters, had not been maintained, nor had security been provided therefor. As such, it was observed that many such buildings had been damaged by wild animals such as elephants and monkeys. Furthermore, furniture, machinery and spare parts in the stores and the factories were decaying.

Lands had decided to auction the machinery, the factory, and the stores, no decision has so far been received in that connection. The Police and the Wildlife Office have been informed to safeguard the buildings from the wild elephants.

securing the other assets.

- (p) The valuable galvanized pipes belonging to the factory had been placed insecurely without shelter. Another stock of metal pipes had been brought away to a nearby army camp and the Buddhist temple. However, no action had been taken to get them back to the factory.
- The former General Manager had granted approval to give the stock of metal pipes of the factory to the army camp and the temple. Action will be taken in due course for recovery of the pipes.
- Action should be taken to securely maintain the stocks existing at the stores of the factory.
- (q) Bids had been invited on 05 June 2017 by the Ministry of Lands for demolition of buildings at the premises of the factory and sale of goods and machinery. As the former Secretary to the Ministry of Land and the former Chairman of the Timber Corporation had been found guilty over the allegations leveled against them on taking bribes in that connection, they had been imprisoned by the court. As such, opening of the factory in accordance with the shareholder agreement signed on 11 August 2016 could not be done.
- Not replied.
- Action should be taken immediately for the disposal of unusable buildings, stores items, and machinery.