

Tea Shakthi Fund – 2012

1. Financial Statements

1.1 Adverse Opinion

In my opinion, because of the significant matters described in paragraph 1.2 of this report the financial statements do not give a true and fair view of the financial position of the Tea Shakthi Fund as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Accounting Deficiencies

The following observations are made.

- (a) The Tea Smallholdings Development Authority had taken action in the year under review, with the concurrence of the Treasury, for the write off of a sum of Rs.74,048,541 payable by the Fund to the Tea Smallholdings Development Authority. Instead of adjusting this amount with retrospective effect, the Fund had brought to account that amount under other income and as such the profit for the year had been overstated by that amount.
- (b) Instead of adjusting the sum of Rs.437,505,030 given by the treasury to the Tea Shakthi Fund as the capital contribution during the years 1998 to 2002 and the year 2004, with retrospective effect, a sum of Rs.43,750,503 had been brought to account under other income in the year under review in accordance with the decision of the Board of Directors to write off the amount in 10 ensuing years, As such, the profit for the year had been overstated by that amount.
- (c) The lease rent amounting to Rs.72,500 received in respect of the ensuing year had been brought into the income of the year under review
- (d) Even though the Fund had agreed to restore the colour separator machine of the Gilimale Factory to the normal working condition prior to leasing out the Gilimale Factory, It had not been done and the cost of repairs carried out by the lessee during the year under review amounting to Rs.250,834 had not been included in the Accounts as a liability. Further, the value of the repaired colour separator machine had not been shown under the Investment Properties as at 31 December 2012.
- (e) A stock of WWP Bags as at the end of the year under review valued at Rs. 1,717,612 had been included in the value of tea stocks while a stock of unusable stock of polythene valued at Rs.971,531 had been included in the stock of stationery.

- (f) Even though a Bank Overdraft of Rs.9,700,079 had been shown in the financial statements over a period exceeding five years, evidence in support of such balance had not been furnished to audit. According to the audit examination it was observed that this account is a closed account and action had not been taken to settle the balance.

1.2.2 Unreconciled Balances

The following observations are made.

- (a) A reconciliation of the balance of three dormant Bank accounts brought forward over a number of years with the confirmation of the Bank balances revealed a difference of Rs.1,201,619.
- (b) Even though the financial statements had been prepared based on a computerized accounting system, the Bank Reconciliation Statements had been prepared based on the balance of cash book maintained manually. A difference of Rs.16,801,672 was reflected between the balances of the cash books under the two systems. As such, it was not possible to establish the accuracy of the Bank balances as at the end of the year under review shown in the financial statements.

1.2.3 Lack of Evidence for Audit.

The evidence indicated against each of the following item had not been furnished to audit.

Item	Value Rs.	Evidence not made available
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<u>Bank Account</u>		
Factory Management Division	875,864	Confirmation of Bank Balances

Balances Receivable and Payable

Balances Receivable	241,447,793	} Detailed Informations and Confirmation of Balances
Balances Payable	205,106,116	
Advance Balances	38,078,755	
Deposit Balances	5,053,841	

1.3 Accounts Receivable and Payable

The following observations are made.

- (a) The balances of current assets amounting to Rs.6,209,334 and current liabilities amounting to Rs.5,034,324 had remained at the time of transfer of the Gilimale Tea Factory to a Tea Smallholdings Development Society on lease basis with effect from 17 May 2012 continue to the carried forward in the accounts without settling the balances.

- (b) The sum of Rs.19,744,732 receivable from a Colombo Tea Brokering Company in respect of the year 2006 and 2007 had not been recovered even by 30 September 2014, the date of audit.
- (c) Advances amounting to Rs.28,311,753 for the construction of buildings which remain recoverable over a number of years had not been settled even by 30 September 2014, the date of audit.
- (d) Even though the Pansaltenna Tea Factory maintained on lease basis had been transferred to the Lessor Company on 19 February 2012 due to recurring losses, The balances receivable and payable as at that date had not been settled. As such, the balances receivable amounting to Rs.3,387,202 and the balances payable amounting to Rs.7,956,886 as at that date are being carried forward in the accounts. Action had not been taken for the recovery of the accounts amounting to Rs.258,491 deposited with the Ceylon Electricity Board for obtaining electricity for the factory. In addition, the assets and liabilities of the Balangoda Tea Factory of which manufacturing work had been ceased with effect from August 2011 and as such balances receivable amounting to Rs.3,829,720 and balances payable amounting to Rs.2,176,440 as at 31 December 2012 had been carried forward in the accounts. Eventhough the Hiniduma Tea Factory had been transferred to the Kalubowitiyana Tea Factory Company Ltd as at the end of the year under review, action had not been taken for the settlement of the balances receivable amounting to Rs.1,288,937 and the balances payable amounting to Rs.1,155,726.
- (e) A sum of Rs.7,521,752 carried forward as balances receivable had also been shown as balances payable over a long period, and action had not been taken to identify and settle those accounts.

1.4 Non –compliance with Laws, Rules, Regulations and Management Decision

 The following instances of non-compliance were observed.

References to Laws, Rules, Regulations and Management Decisions	Non-Compliance
(a) Tea Shakthi Act No.47 of 2000 i. Paragraph 2(iii) of Section 03	Even though the Act provides for the Deputy General Manager of the Tea Small Holding Development Authority should be appointed as an ex-office member of the board of directors, appointment in that place had not been made as such a post does not exist in the Authority.

- ii. Paragraph 2 (v) of Section 03

Even though the Minister in charge of the subject of Plantation Industry should appointed a representative of the Ministry a consultant of the Ministry had been appointed as a member of the Board of Directors. In addition to that an officer of the Ministry had been appointed as an observer to represent the Ministry and paid allowances.

- (b) Financial Regulation of the Democratic Social Republic of Sri Lanka
 - i. Financial Regulation 371 (2) (b)

Specific limits had not been prescribed for the grant of advances it was observed during the course of an audit test check that advances ranging from Rs,20,000 to Rs,155,000 had been granted in 08 instances.
 - ii. Financial Regulation 371 (2) (c)

Even though the offices should be paid advances for specific purposes, it was observed that advances amounting to Rs.58,250 obtained by 2 officers had been retained in hand over considerable period without been used for the purpose and settle subsequently.
 - iii. Financial Regulation 395 (c)

Bank Reconciliation Statements had not been prepared in respect of 04 Bank Accounts of the Fund.
 - iv. Financial Regulation 396

Action had not been taken in terms of the Financial Regulation on cheques valued at Rs. 96,497 issued but not presented for payment for more than 06 months.

- (c) Public Enterprises Circular No: PED/12 of 02 June 2003 Section 6.5.1
 - i. Even though in accounts for the year 2012 should be presented to the Auditor General within 60 days after the close of the financial year, the financial statements had been presented only on 18 March 2014.

ii. Even though the draft annual report for the year 2012 should have been presented to the Auditor General as specified in the Circular, it had not been presented even by 31 December 2014.

(d) Public Administration Circular No. 41/90 of 10 October 1990

The fuel consumption of motor vehicles had not been tested as specified in the Circular.

2. Financial Review

2.1 Financial Results

According to the Financial Statements presented to audit, the overall profit of the Tea Shakthi Fund for the year ended 31 December 2012 amounted to a profit of Rs.82,199,299 as against the loss of Rs.85,696,151. That as compared with the preceding year indicated an improvement of Rs. 167,895,450 or 195.92 per cent. The inclusion in the income a sum of Rs. 74,048,541 payable to the Tea Smallholdings Development Authority as the two parties had agreed to waive the payment and the addition of Rs. 43,750,503 out of the Government Grants amounting to the Rs. 437,505,030 received during the years 1998 to 2002 and the provision of Rs. 6,878,128 made for the non-payable sundry creditors to the profit had been the main reason for the improvement.

3. Operating Review

3.1 Performance

(a) Factory Division

According to the Factories Profit and Loss Accounts for the year 2012 the overall factory loss of the Fund (including Head Office expenditure) amounted to Rs. 57.695 million and that, as compared with the loss of Rs. 73.600 million for the preceding year, had decreased by Rs. 15.905 million or 21.6 per cent. The increase of field income for the year under review by Rs. 1.824 million or 31.6 per cent and the increase of the Factory gross profit by Rs. 16.091 million or 24.9 per cent had been the reasons therefor.

The profit /loss of each factory from the year 2008 to the end of the year under review is given below.

Factory	Profit/Loss				
	Rs. 000				
-----	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Deniyaya	(7,349)	(4,126)	1,054	7,913	6,709
Walahanduwa	(2,297)	(3,312)	558	1,436	1,940
Mawarala	(6,108)	(3,653)	158	(801)	(1,946)
Elpitiya	(7,990)	(16,604)	(10,105)	(8,994)	(13,298)
Hiniduma	(3,792)	(14,712)	(13,223)	(6,636)	(10,015)
Balangoda	(8,527)	(10,316)	(3,821)	(8,157)	(4,813)
Gileemale	(1,991)	(3,593)	(3,148)	(3,671)	(8,645)
Pusalthanna	(2,713)	(7,943)	(7,010)	(5,725)	(11,015)
Raigam Korale	(7,579)	2,191	7,670	16,977	10,712
Kothmale	(6,132)	(8,901)	(11,348)	(6,120)	(7,430)
Keppetipola	(1,285)	(5,223)	1,239	10,046	(4,199)
Passara	6,640	2,345	6,342	17,162	(1,032)
Mahaweli	(899)	245	(2,738)	2,345	3,265
Daraniagala	(3,989) *	-	-	-	-
Yatinuwara	(3,684)*				
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Total	(57,695)	(73,602)	(34,372)	15,775	(39,767)
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- These factories had been started in the year 2012 and had not generated income. The following observations are made in this connection.
 - (i) Out of 15 above factories of the Fund, 6 factories had sustained continues losses over a period of 05 years and all factories, other than Passara Factory had sustained losses during the year under review.
 - (ii) According to the Corporate plan for the years 2008 to 2012, profits amounting to Rs.1.125 million had been expected from the Bulathkohupitiya Factory by the end of the year under review, the production work of the Factory had not been commenced even by 30 November 2014.
 - (iii) The production work of the factories Hiniduma, Balangoda, Gilimale and Pansalthenna out of the above factories had been terminated during the year under review due to incurring losses. Nevertheless, the management of the Hiniduma factory had been transferred from May 2012 to the Kalubowitiyana Tea factory Ltd, on the basis of obtaining 1/3 of the profit, the Gilimale Factory had been transferred from on annual lease basis to a Tea Small holder Development Society and the Pansalthenna Tea Factory had been transferred to the lessee concerned.

(iv) Even though the production work of the Balangoda and Pansalthenna Factories had been stopped, the expenditure of Rs.7,916,717 comprising attendance incentives amounting to Rs.272, 292, Bank overdraft interest amounting to Rs. 1,527,238, house rent amounting to Rs. 147,876 and employees compensation amounting to Rs. 5,583,190 had been spent during the year under review.

(b) Tea Production

The following matters were observed in this connection.

(i) According to the information received in audit the tea production for each factory during each of the 5 past years had been as follows.

Factory	<u>Tea Production (Kilograms)</u>				
	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Deniyaya	218,364	269,055	310,725	320,422	362,019
Walalanduwa	241,296	260,930	257,830	215,419	328,902
Mawarala	111,197	171,257	175,756	135,765	170,915
Elpitiya	118,400	148,022	178,077	178,521	305,722
Hiniduma	*	106,607	197,829	86,080	117,190
Balangoda	**	74,290	189,991	30,799	236,181
Gileemale	***	-	-	253	103,656
Pansalthanna	****	104,900	89,478	89,759	237,718
Raigam Korale	300,603	400,380	348,710	373,228	415,690
Kothmale	99,199	200,027	103,042	170,888	306,975
Keppetipola	261,056	243,507	273,322	266,069	335,648
Passara	290,487	307,929	328,441	364,673	417,012
Mahaweli	351,989	458,806	301,755	381,466	749,879
Daraniagala	40,599	--	--	--	-
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Total	2,033,190	2,745,710	2,754,956	2,613,342	4,087,507
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(ii) The production of all factories, except Kappetipola had decreased and as compared with the preceding year, the overall production of factories had decreased by 26 per cent. The production of the Deniaya, Elpitiya and Passara Factories had continuously decrease annually since the year 2008.

- (iii) The Fund had failed to direct the Factory Division, with a view to achieving objectives of the fund through increasing the profits earned from the factories. The particulars relating to the production during the year under review, according to the Performance Reports for the year under review are given below.

Factory	Targeted tea production according to action plan	Actual Tea production	Variance	Machine capacity	Machine utilization	Underutilization of machine
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	Kg	Kg	Percentage	Kg	Kg	Percentage
Deniyaya	379,260	218,364	(42.4)	2,352,000	1,074,155	54.3
Walahanduwa	731,430	241,296	(67.0)	4,536,000	1,168,658	74.2
Mawarala	433,440	111,197	(74.3)	2,688,000	537,241	80.0
Elpitiya	595,980	118,400	(80.1)	3,696,000	558,006	85.0
Raigam Korale	595,980	300,603	(49.6)	3,696,000	1,446,959	61.0
Daraniyagala	296,932	40,599	(86.3)	1,800,000	192,832	89.2
Kothmale	379,260	99,199	(73.8)	2,252,000	442,018	80.3
Keppetipola	541,800	261,056	(51.8)	3,360,000	1,204,787	64.1
Mahaweli	650,160	351,989	(45.9)	4,032,000	1,601,808	60.2

Following observations are made in this connection

- (a) The actual tea production as compared with the expected production had been at a very low level and the variance there of range between 42 per cent to 86 per cent.
- (b) According to the above information, the machinery of the overall factory system had been in the underutilized level and in certain factories had been above 90 per cent.
- (c) Local Tea Sale Division

Even though the Local Tea Sales Division had expected to earned a profit by the end of the year under review, nor been incurring losses over past 6 years and the cumulative loss incurred up to the end of the year under review amounted to Rs.15.84 million. The income for the year under review as compared with the preceding year had decrease by Rs. 0.95 million or 105 per cent.

(d) Fertilizer Division

According to the Profit and Loss Account of the Fertilizer Division, a profit of Rs.13.93 million had been earned and that as compared with the preceding year, indicated a decrease of Rs.5.72 million on 29 per cent in addition, the income from the sale of fertilizer as well, had as compared with the preceding year indicated a decrease of Rs.42.76 million or 46 per cent.

(e) Welfare Division

A sum of Rs.16,177,732 had been paid to 745 beneficiaries during the year under review as insurance indemnity. The total membership of the Insurance Benefit scheme, as at the end of the year under review including 66 members, who had received membership during the year, had been 140,368 members.

3.2 Management Inefficiencies

The following observations are made.

(a) Cash and Bank

- (i) Even though a sum of Rs. 118.3 million had been made available from the year 2000 – 2003 from the Welfare Fund to the Tea Smallholder Society of the Tea Shakthi Fund to meet the financial needs of the Tea Shakthi Factories, the factories had not settled those loans to the Welfare Funds even up to the end of the year under review. Even though 4 factories had been closed down by the end of the year under review, course of the action for the settlement of the loan granted to those factories had not been taken.
- (ii) Even though a bank account of the fund with a balance of Rs.16,205 from the beginning of the year under review, to bank accounts with balances amounting to Rs.58,186 of the year 2009 and the bank account with a balance amounting to Rs.223,447 over a period exceeding 5 years had been dormant, proper course of action had not been taken in that connection.
- (iii) Even though there were fixed deposits valued at Rs.83.44 million as at the end of the year under review, interest amounting to Rs.8.49 million had been paid for the Bank overdraft obtained by the Fund during the year under review. That, as compared with the preceding year, indicated an increase of Rs 4.17 million.

(b) Lands and Buildings

- (i) Even though the cost of the Elpitiya, Hiniduma and Raigamkoralaya Factory buildings and the Horana Fertilizer Stores had existed from the inception of the Fund, those had been shown as Rs.62,391,999 in the accounts, the value of the lands on which those buildings are situated had not been brought to

account. The Fund had not taken action even by 30 November 2014 to get the ownership of those infavour of the Fund.

- (ii) The Fund had agreed to obtain a Land 40 perches in extent valued at Rs.28 million on lease for period of 50 years from the Urban Development Authority for the construction of the Head Office of the Fund and had paid a sum of Rs.8,082,256 as an advanced to that Authority on 31 March 2010. Nevertheless according to the decision of the Board of Directors taken in the year under review, it had been proposed to construct that building in a different site' The advance paid to the Urban Development Authority had not been recovered even by 30 November 2014.
- (ii) A physical verification of the assets of the Hiniduma and Gilimale Factories transferred on the annual lease basis had not been carried out as at the end of the year under review.
- (iv) Even though an agreement for the take over the lease of the Pansalthenna Factory by the Fund had been entered in to between the two parties on 18 September 2002 the lease agreement had not been registered even up to the handover of the factory (19 February 2012) Even though the relevant files indicated that the Fund had spent a sum of Rs.7,664,603 during the lease period for renovation to the factory, terms and conditions of the recovery of such expenditure had not been included in the agreement accordingly such expenditure was observed in audit as a loss incurred by the institution.
- (v) Even though a larger number of assets of the Balangoda Tea Shakthi Factory of which the production work had been leased with effect from August 2011 had been transferred to the Deraniyagala Factory and certain other assets to the other factories, a tractor and a trailor , 4722 refuse tea bags a stock of picketed OPI tea, tea packeting covers and a large quantity of refuse tea, machinery and removed machinery spare parts and a stock of fertilizer existing over a number of years had been deteriorating in the factory premises without being made use of.
- (vi) A larger portion of the properties of the Balangoda Tea Factory had been occupied unauthorized persons and constructed permanent buildings after the factory was closed down due to the weak supervision of the management. It was revealed in audit that a case in this connection is pending with District Court Balangoda. It was observed that the quarters and the latrines of the factory are deteriorating due to lack of proper maintenance , The lands, buildings , machinery and other equipment of the factory valued at Rs.23,705,431 had been idling without be made use of. According to the valuation report dated 3 February 2014 , the market value of the above land and buildings had been computed at Rs.22,500,000.

- (vii) Even though a Memorandum of Understanding had been entered in to between both parties for the transfer of management affairs of the Hiniduma Tea Shakthi Factory to the Kalubivitiyana Tea Shakthi Factory company Ltd, for a period of 25 years with effect from 01 June 2012 , the validity of the agreement was observed as questionable as the land does not belong to the Fund. The final account of the fund had been prepared after the hand over of the factory to the above company and depreciation of the 5 month prior to the hand over amounting Rs.1,187,020 only had been brought to account. Even though it was stated in the accounts that the sum of Rs.1,661,829 for the income of 07 months would be recovered from the company concerned, the information there on had not been included in the agreement.

(c) Computers and Software

Eventhough a computer software package valued at Rs.2,435,000 had been purchased in the year 2010 for the preparing of consolidated accounts of the Head Office of the Fund and all factories, preparation account by using that system had not been commenced even by 30 November 2014. The value of the computers of the factories had been shown under the Head Office in Register of Fixed Assets instead of been shown under the respective factories.

3.3 Identified Losses

The following observations are made

- (a) A sum of Rs.19.9 million receivable in respect of a stock of tea exported to Russia in the year 2002 under the Russia Lanka Joint Agreement had been written off from the account without the approval of the treasury.
- (b) Stocks of fertilizer had been ordered without considering the requirements made by the green leaf owners and as such losses amounting Rs.39,248 and Rs.114,946 respectively had been incurred due to out dating of fertilizer of the Kothmale and Mahaweli Factories.
- (c) A sum of Rs.204,934 had been paid during year 2012 as surcharges due to the failure to pay gratuity on the due date with the terms of the Payment of Gratuities Act.
- (d) According to the physical stock verification reports, it was observed that 1,574 tea packets containing 369 kilograms of tea of the tea camp and 509 kilograms of BOP finings (tea bulk) of the local Tea sales division had been out dated stocks of tea.

3.4 Human Resource Management

According to the information furnished by the fund the approved staff of the Fund as at the end of the year under review. Had been 89 and according to the collective agreement the approved staff of 09 factories had been 170. Out of the overall staff 27 posts of the Head Office and 62 posts of the Factory staff had been vacant. That included 14 staff officers and 20 Technical Officers of the Factory Division.

3.5 Control and Maintenance of Motor Vehicles

According to the information received by audit the following matters were observed in connection with the fleet of 44 motor vehicles (including tractors ,trailers and lorries) of the Fund.

- (a) Action had not been taken even by 30 November 2014 for the transfer of 23 motor vehicles to the Fund valued at Rs.14,885,880 shown in the schedule of motor vehicles as had the end of the year under review which are in running condition or can be used for running after carrying out repairs.
- (b) Nine Motor vehicles belonging to the Deniyaya, Keppetipola and Kothmale Factories included in the motor vehicles fleet and not belonging to the Fund which cannot be repaired and used had been deteriorating due to the failure of dispose of them.
- (c) Nine Motor vehicles including tractors ,trailers , lorries and landmasters valued at Rs.2,862,921 shown under the Balangoda, Mahaweli, Mawarala and Raigam koralaya factories in the Schedule of Fixed Assets as at the end of the year under review had not been included in the fleet of motor vehicles.

4. Accountability and Good Governance

4.1 Corporate Plan and Action Plan

The following observations are made.

- (a) The Corporate Plan prepared for the years 2008 to 2012 had not been include the salient features such as the current resources of the Fund, Organization Chart, the strategic plans for the planned period clearly identified goals and targets to be achieved during the period identifying the responsibilities assigned to the respective managers as specified in Section 5.1.2 of the Public Enterprises Circular No PED/12 of 2 June 2003.
- (b) Non achievement of the Profitability Targets shown in the Corporate Plan

Even though objectives had been set for the improvement of profits received annually from the factories to Rs.150 million by the year 2012 for increasing the economic benefits of shareholders of the Fund and for the increase of the profit receive from the Local Tea Sales Division by Rs.1 million each year. The profit of the Factory Division had been decreasing annually since the year 2009 while the Local Tea Sales Division had been incurring losses since the year 2006 to the end of the year under review.

Even though the Vision of the Fund is “being the excellent institution committed to the betterment economic social status of the tea smallholders by raising the value of the share capital of the member shareholders.” it appears from the above matters, that the Fund had not achieve that objective. As members of the Fund had not received

any benefits what's so ever during a period exceeding 5 years, shareholders had transferred 107 891 shares valued at Rs.1,078,910 by the end of the year 2013

4.2 Budgetary Controls

According to the budget of the Fund , significant variances between the budgeted and the actuals were observed, thus indicating that the budget had not been made use of an effective instrument of management control.

5. Systems and Controls

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

- (a) Accounting
- (b) Cash Control
- (c) Factory Operations
- (d) Assets Management
- (e) Stock Control