

## **State Timber Corporation 2013**

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The audit of financial statements of the State Timber Corporation for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under any direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section, 29 of the State Industrial Corporations Act No.49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2) (c) of the Finance Act appear in this report.

### **1.2 Managements Responsibility for the Financial Statements**

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

### **1.3 Auditor's Responsibility**

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My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Accounting Standards consisted with International Standards of Supreme Audit Institutions (ISSAI 1000-1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of financial statements 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 Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### **1.4 Basis for Qualified Opinion**

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My opinion is qualified based on the matters described in paragraph 2.2 of this report.

**2. Financial Statements**

**2.1 Qualified Opinion**

In my opinion except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Timber Corporation as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**2.2. Comments on Financial Statements**

The following non-compliances with Sri Lanka Accounting Standards were observed.

**(a) Sri Lanka Accounting standard-16**

- (i) Action had not been taken to revalue and account for the 6,705 items of assets costing Rs.794, 855,634 and with net value of Rs.83,525 as at the end of the year under review and the property, plant and equipment costing Rs.5,827,394 and shown at zero value as at the end of the year which are still being used by the Corporation.
- (ii) The method of depreciation applied in respect of fixed assets should be reviewed at the end of each financial year and if the pattern of economic benefit received therefrom is considerably changed, the method of depreciation should be changed to reflect that pattern. However, the Corporation had not complied with those requirements.
- (iii) Even though the entire class of property should be revalued in the revaluing of property, plant and equipment, action had not been taken to revalue all the lands transferred from the Department of Forests and disclose in the all financial statements.

**(b) Sri Lanka Accounting Standard-37**

When the liability can be specifically estimated and the liability is specific, provision for contingent liabilities should be made. Nevertheless, provision for the payment of arrears of salaries amounting to Rs.1,957,174 payable to an officer who had been interdicted but subsequently exonerated from the charges, had not been made by the Corporation.

**(c) Sri Lanka Accounting Standard-40**

A part of the Head Office building of the Corporation had been rented out to private parties. (The net value of the building as at 31, December 2013 amounted to Rs.5) Action had not been taken to assess the rented out part and the part used by the Corporation separately and to disclose in the financial statements as investment assets and property, plant and equipment respectively.

## 2.2.2 Unreconciled Control Accounts

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The following differences were observed in a reconciliation of the balances shown in the accounts presented as at 31 December 2013 with the relevant schedules.

Particulars	Balance according to the Account	Balance according the Schedules	Difference Increase/(Decrease)
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	Rs.	Rs.	Rs.
<b>Mechanical Engineering Division-Kaldemulla</b>			
Stock and Spare Parts Account	20,796,319	20,689,413	106,906
<b>Furniture Complex at Boosa</b>			
Provision for Retirement Gratuity	3,973,635	3,734,080	239,555
<b>Timber Complex at Boosa</b>			
Provision for Retirement Gratuity	11,133,346	12,015,148	(881,802)

## 2.2.3 Unexplained Differences

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According to the financial statements, the stumpage payable to the Department of forest as at the end of the year under review amounted to Rs.661,562,629 whereas according to the records of the Department, the stumpage receivable from the Corporation amounted to Rs.706,610,518. The difference of Rs.45,047,889 was not explained to audit.

## 2.2.4 Lack of Evidence for Audit

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The following observations are made.

- (a) Evidence in support of the expenditure of Rs.1,100,000 incurred for food and T-shirts provided to employees participated in the “Shramabhimani” meeting was not made available for audit.
- (b) Ever though payments amounting to Rs.743,295 and Rs.1,113,062 had been made for the first and the second additional works of the construction contract of the Sellakataragama Circuit Bungalow respectively, measurement sheets, work reports or bills were not made available.

## 2.2.5 Deficiencies in Contract Administration

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An overpayment of Rs. 2,174,394 had been made in excess of the of actual expenditure in making payments on the Sellakataragama Circuit Bungalow construction contract.

### **2.3 Accounts Receivable and Payable**

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The following observations are made in respect of trade debtors and other accounts receivable.

- (a) According to the financial statements presented, Trade Debtors receivable as at 31 December of the year under review amounted to Rs.475,392,716. Out of this Rs.12,442,454, Rs.5,105,542 and Rs.45,134,668 had been the balances older than 4 years, 3 years and 2 years respectively.
- (b) Action had not been taken to recover the dues amounting to Rs.568,500 receivable from a Government Department from years prior to the year 2009 and Rs.11,873,954 relievable from a private company, term in year 1983 even up to the end of August 2014. The recoverability of these debts appear uncertain.
- (c) Debts receivable from 35 Government Institutions over periods ranging from 1 to 2 years amounted to Rs.48,830,545 and the amount receivable from a private firm since the year 2012 amounted to Rs. 108,329.
- (d) Values written off as bad debts in the years 2010 and 2012 amounted to Rs.1,780,932 and Rs.3,877,002 respectively and the approval of the Treasury for that had not been obtained.
- (e) Loans recoverable from 27 Public Officers who had purchased furniture on credit basis under the “Prasada Abimani” Scheme amounting to Rs.693,435 had remained outstanding from 1 to 4 years and action had not been taken to recover these outstanding debts from the parties concerned.
- (f) Action had not been taken to recover the sundry debtor balances of 7 Regions amounting to Rs.555,346 remaining outstanding for periods from 2010 to 2013.
- (g) Advances paid to timber suppliers should be deducted from the last payment after the completion of the supply. As action had not been taken accordingly, a sum of Rs.1,358,192 relating to 03 Regions respect of the years from 2010 and 2012 had to be further recovered.
- (h) The Corporation had granted an interest free loan of Rs.2, 000,000 in the year 1988 to the Katharagama Ashtapala Fund. A sum of Rs.38, 000 had been recovered during the year under review and the balance further recoverable amounted to Rs.1,037,000.

The following observations are made in respect of the trade creditors and other accounts payable.

- (a) The stumpage payable to the Department of Wildlife and the Department of Forests by the end of the year under review amounted to Rs. 335,619 and Rs.661,562,629 respectively and action had not been taken to settle those amounts.

- (b) Action had not been taken either for writing back to income or the settlement of liabilities included in the refundable bid deposits amounting to Rs.6,565,130 and security deposits amounting to Rs.12,508,011 remaining over periods ranging from 01 year to 05 years.
- (c) Deposits of Rs.4,674,305 retained at the completion of various supplies and constructions included balances that remained for over 1 year. Action had not been taken to settle those.
- (d) Action had not been taken to settle the gang nail deposit of Rs.2,295,360 remaining for more than one year.

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

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Instances of non-compliance with laws, rules, regulations and management decisions are given below.

##### **Reference to Laws, Rules, Regulations, etc.**

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##### **Non-compliance**

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| (a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka   |  |
| (i) Financial Regulation 104 (3)  | Long delays were observed in submission of reports through form General 283 relating to 07 events that occurred in the previous years and the year under review.   |
| (ii) Financial Regulation 104 (4)   | The full report in respect of accidents to 03 motor vehicles had not been made available for audit.  |
| (iii) Financial Regulation 110  | A Register of Losses and Damage had not been maintained even up to the date of audit on 31 July 2014.  |
| (iv) Financial Regulation 571 (2)   | Action in terms of this Regulation had not been taken in respect of deposits amounting to Rs.3,319,300 made by suppliers of goods and contractors lapsed for over 2 years.                                   |
| (b) Section 10 of the Establishments Code of the Democratic Socialist Republic of Sri Lanka and the Public Enterprises Circular No. 118 (a) dated 23 May 1997 | One twentieth allowance totaling Rs.227,256 had been paid to 8 Executive Officers of the Corporation from January to June 2013 as “ex-gratia payment” contrary to the provisions in the Establishments Code. |

- (c) Manual Of Consultancy Services of the National Procurement Agency of 2007
- (i) Section 2.2.1
- Although the Technical Evaluation Committee to select the Consultancy firm should be appointed by the Secretary to the line Ministry such instructions had not been complied with in the appointment of relevant committee.
- (ii) Section 2.6.3
- In the establishment of committees for the selection of consultancy services institutions action had not been taken in accordance with instructions of this section.
- (d) Procurement guidelines of 2006
- (i) Section 2.8.1
- Technical Evaluation Committees should be appointed before calling for bides procurements and construction contracts. However the Evaluation Committee had been appointed only after calling for bids and the receipt of Quotations.
- (ii) Section 2.8.4
- (i) In purchasing technical equipment with high values an outside person who has the expertise knowledge should be appointed to the Technical Evaluation Committee. Nevertheless the Corporation had not appointed such a person to the committee.
- (ii) Even though the maximum members of a procurement Technical Evaluation Committee should be 5 a sum of Rs.26,000 had been paid to members who had participated in excess of that limit.
- (e) Management Services Circular No.39 of 26 May 2009 and the Scheme of Recruitment
- (i) Salary increments had been granted to 16 Senior Management Officers of the Corporation and a sum of Rs.398,320 had been paid by 30 April 2014 contrary to circular instructions. In addition 5 per cent of special allowance amounting to Rs.19,916 and 15 per cent of allowance amounting to Rs.59,748 computed on the value of the salary increments over paid had also been paid .

- (ii) Salary increments had been granted to 2 officers without the approval of the Department of Management Services on merit basis and a sum of Rs.368,200 had been paid thereon.

### 3. Financial Review

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#### 3.1 Financial Results

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According to the financial statements presented the operations of the Corporation had resulted in a net profit of Rs.339,127,677 for the year under review as compared with the net profit of Rs.201,681,308 for the preceding year, thus showing an increase of Rs.137,446,369 in the net profit. The decrease of the levy paid to the Treasury in the year under review by Rs.550 million as compared with the preceding year had been the main reason for the increase of pre-tax net profit.

#### 3.2 Analytical Financial Review

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Actual operating and the liquidity ratios of the year under review and the preceding year are given below.

	2013 Percentage	2012 Percentage
(a) <b><u>Operating Ratios</u></b>		
Gross Profit Ratio	41.38	47.29
Net Profit Ratio	11.48	6.17
(a) <b><u>Liquidity Ratios</u></b>		
Current Ratio	3:1	3.74:1
Quick Ratio	2.06:1	2.75:1

The following observations are made in this connection.

- (i) Sales turnover and the gross profit ratios had dropped by 11.5 percent and 5.91 percent respectively in the year under review as compared with that of the previous year.
- (ii) Even though the other operating income had decreased by 19.28 per cent in the year under review as compared with that of the previous year, the levy paid to the Treasury had decreased by 91.67 per cent and as such the net profit ratio had increased by 5.31 per cent. In review of the material decrease of the levy paid to the Treasury net profit ratio of 6.17 per cent in the previous year had increased to 11.48 per cent in the year under review.

#### **4. Operating Review**

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##### **4.1 Performances**

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According to the Action Plan for the year under review, it was planned to generate a total income of Rs.1,254 million consisting of Rs.429 million and Rs.825 million from sale of sawn timber and sleepers respectively. However, the actual sales income amounted only to Rs.623 million, representing 50.3 per cent. Failure to implement strategic marketing plans and the preparation of unrealistic estimates by the Corporation had affected this situation.

##### **4.2 Transaction of Contentious Nature**

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- (a) Due to discrepancies caused by selling the good condition timber removed from the area submerging under “Rambaken Oya” reservoir by classifying as class II timber or lower than that at low prices in wayside sales and by cutting trees outside the approved limit of “Rambaken oya” Project, a loss of Rs.35,169,565 had been caused the Government.

The following matters were observed in this connection.

- (i) According to the agreement entered into by the contractors with the Corporation the contractor had not supplied timber stores in terms of the agreement and rates at Mansala had been reduced on requests made by contractors, contrary to the conditions of contract in certain instances without written requests of contractors and marketing timber which should be supplied to Corporation timber stores classified as special class and above the class II timber kept for the Mansala sales had been the main reason for these discrepancies.
- (ii) Incorrect price reductions beneficial to the construction had been recommended and about to the Head Office Staff by the Assistant Manager and the Manager (Ampara). Those incorrect recommendations were approved by the Head Office authorities and as such timber in good condition had been sold at lesser prices.
- (iii) As the Deputy General Manager Operations had recommended, action had not been taken to fell timber through a Corporation method using plant and machinery, as there are no geological variances in the work sites. However prices had been reduced stating that work sites were in most difficult areas, beneficial to the contractors. Similarly, a contractor had made a request on 17 June 2009 to reduce the rates at wayside sales stating that the work site is in difficult area the Price Committee had reduced the prices on 16 June 2009 request even before such request was made.
- (iv) In grading timber as good condition and sub grade timber, all timber, not coming under the good condition had been graded as a sub grade. E.g.: Both logs with 5 percent defects and 95 percent defects had been marketed at the same price.



- (v) Even though it was informed that Satin wood should be stored , without doing so, those were referred to Mansala sales.
  
- (vi) Trees had been felled outside the approved limit of ‘‘Rambaken oya’’ Project. Statements of the Irrigation Engineer confirmed that trees were felled beyond the limit at the first stage and various varieties of trees had been felled specially far beyond the Monaragala District boundary. According to the statements of the District Secretary Ampara ‘‘This is not a mistake in an administrative process but an organized grave forest crime purposely done.’’ According to paragraph 21(1) of the report No: 01/01/03/03/27/10 dated 17 September 2011 issued by the Chief Internal Auditor of the Ministry of Environment, very valuable trees such as Kumbuk, satin wood, etc. had been felled and removed in the area, not within the submergence of the reservoir as well as in the area not approved for removal. Trees were felled beyond the Monaragala District boundary, though not-approved so far.

#### **4.3 Uneconomic Transactions**

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The following matters were observed.

- (a) Even though then Corporation had set up a joint venture in the year 2001 by incurring an initial expenditure of Rs.468,000 and investing a sum of Rs.30, 000,000 in a company, the Corporation had not received any return up to date.
  
- (b) In selecting a suitable institution from the quotations submitted by the consultancy firms for consultancy services, the bid had not been awarded to the lowest bid contrary to the inductions in the Manual of Consultancy Services and as such the Corporation had incurred a financial loss of Rs.1,738,000.

#### **4.4 Personnel Administration**

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Contrary to the instructions stated in the letter No.DMS/E2/2/58/4/371/1/1 dated of March 2011 of the Department of Management Services, 26 posts of Management Trainees had been recruited without the Treasury approval. Similarly 14 unqualified persons had been called for the interview and 03 of them had been recruited to the posts by awarding makes spuriously.

#### **4.5 Motor Vehicles Utilization**

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A Jeep purchased in the year 2012 at a cost of Rs.9,296,000 for the Chairman had met with accidents in 4 instance out of which 3 accidents had occurred when the vehicle was driven by the Chairman. Losses caused to the vehicle while being driven by the Chairman in 2 instances amounted to Rs.60,788 and Rs.294,276 respectively. However action had not been taken to recover the loss in terms of Financial Regulations. Likewise, this vehicle had been severely damaged due to the last accident occurred on 20 January 2013 but the loss sustained by the Corporation from that accident had not been estimated even up to the end of August 2014.

## **5. Accountability and Good Governance**

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### **5.1 Corporate Plan and Strategic Plan**

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The following observations are made.

- (a) The Corporate Plan for the period 2013-2017 had been submitted to the Auditor General only on 17 December 2013 contrary to Section 5.1.1 of the Public Enterprises Circular No: PED 12 of 02 June 2003.
- (b) Even though the strategies to be followed in the year under review for the achievement of the goals and targets for the years 2013 - 2017 had been stated in the Corporate Plan the Corporation had not been able to implement the strategies for the year under review due to the delay in the preparation the Corporate Plan.
- (c) Information regarding the performance achieved in the year 2013 out of 50 Programs expected to be implemented during the year under review had not been made available for audit.
- (d) The following objectives stated in the State Industrial Corporations Act, No.49 of 1957 and the Gazette Extraordinary No: 178/10 dated 05 February 1982 and No: 1190/7 dated 26 June 2011 under expansion of the scope of the Corporation had not been included in the objectives of the Corporate Plan and as such action had not been taken to achieve those objectives by the Corporation.
  - (e) Commencement of Agricultural Products.
  - (f) Export of timber related finished and semi-finished products.
  - (g) Import of Cane.

### **5.2 Procurement Plan**

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There were differences between the information stated in the Procurement Plan prepared and the budget information but the Procurement Plan had not been reviewed and updated.

### **5.3 Budgetary Control**

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Variances ranging from 4 per cent to 25 per cent were observed between the budget prepared by the Corporation and the actual values thus indicating that the budget had not been made use of as an effective instrument of financial control.

### **5.4 Unresolved Audit Paragraphs**

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Even though the Chairman of the Corporation had informed on 28 June 2013 that further action would be taken after the receipt of the Report of the Joint Committee appointed to recommend the action to be taken against the contractor and the Corporation officers in respect of unauthorized felling in the Bangalawatta Chapelton commercial level plot of land, no action whatsoever had been taken in that connect even by 31 July 2014.

**6. Systems and Controls**

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Weaknesses in systems and controls observed in audit were brought to the attention of the Chairman of the Corporation from time to time. Special attention is needed in respect of the following areas of control.

- (a) Budget
- (b) Stock Control
- (c) Fixed Assets Management
- (d) Contract Administration
- (e) Procurement
- (f) Accounting
- (g) Human Resources Management