

## **Tea Shakthi Fund - 2014**

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The audit of financial statements of the Tea Shakthi Fund for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 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 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 Section 13 (1) of the Finance Act, No. 38 of 1971 and Section 13(2) of the Tea Shakthi Fund Act, No.47 of 2000. My comments and observations which I consider should be published with the Annual Report of the Fund in terms of Section 14 (2) (c) of the Finance Act appear in this report.

### **1.2 Management's Responsibility for the Financial Statements**

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The 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 Auditing Standards consistent with International Auditing 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 judgement, including the assessment of the 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 Fund's preparation and fair presentation of the 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 Fund'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 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**

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### **2.1 Qualified Opinion**

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In my opinion, except 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 Tea Shakthi Fund as at 31 December 2014 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**

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#### **2.2.1 Going concern of the Fund**

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In considering the financial results for the last 5 years, of the Fund, the loss for the year 2010 amounting to Rs.28.52 million had become Rs.127.82 million in the year 2014, being increasing annually except for the year 2012. As 10 per cent of the sum of Rs.437.5 million given by the Treasury as capital grants prior to the year 2005 had been adjusted to the revenue annually since 2012 contrary to Sri Lanka Accounting standards the above loss position had been understated. In view of taking a sum of Rs.74 million to the revenue which had to be paid to the Tea Smallholding Development Authority, a profit was shown in the year 2012.

In considering the net assets of the Fund it was Rs.651.31 million in the year 2010 and it had reduced up to Rs.55.41 million in the year 2013 and it had converted into net liability position of Rs.72.42 million by 2014. Similarly the production activities of the factories belonged to the Fund had been stopped by July 2016 and as such employee remunerations for 2 months had not been paid. Accordingly, it was observed that going concern of the fund appears to be uncertain without government or any other financial assistance.

#### **2.2.2 Sri Lanka Accounting Standards**

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Instances of non-compliance with Sri Lanka Accounting Standards are given below.

##### **(a) Sri Lanka Accounting Standard 01**

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In the preparation of financial statements, except required or permitted by a standard, income and expenditure should not be off set each other. Nevertheless, the net rent income of Rs.1,208,010 had been brought to accounts under other income after deducting the maintenance expenditure from the rent income of the year under review.

**(b) Sri Lanka Accounting Standard 16**  
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When the fair value of a revalued asset is materially different from the carrying value another revaluation has to be done. However, the fixed assets of the fund had not been revalued after the year 2016.

**2.2.3 Accounting Deficiencies**  
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Depreciation on Plant and Machinery of the year under review had been under accounted by Rs.588,624.

**2.2.4 Lack of Evidence for Audit**  
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Age analysis and confirmation of balances in respect of receivable balances and payable balances totalling Rs.263,052,111 and Rs.315,491,677 respectively included in the final accounts of the year under review were not made available for audit.

**2.2.5 Unexplained Differences**  
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A difference of Rs.96,450 was observed between the cash book manually prepared and the computerized cash book and action had not been taken to identify this difference.

**2.3 Accounts receivable and Payable**  
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The following observations are made.

- (a) Advances totaling Rs.18,042,351 given for the construction of Bulathkohupitiya and Pothupitiya factories in the year 2001 had not been settled even by the end of the year under review. The construction of these factories had been halted halfway.
- (b) The construction of Yatinuwara factory had been given to a private company in the year 2005. As the construction of the factory had been halted halfway, the advance of Rs.10,269,400 paid to that company had not been recovered even by the end of the year under review.
- (c) The Hiniduma Tea factory had been vested in the Kalubovitiyana Tea company since 2012 on lease basis and action had not been taken to recover the dues amounting to Rs.1,661,828 receivable to the Fund.
- (d) The loan balance of Rs.2,099,029 receivable in respect of lorries given to small tea holding societies for the use of factories belonging to the Tea Shakthi Fund had been brought forward since the year 2013 without being recovered.

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

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The following instances of non-compliances with Laws, Rules, and Regulations, were observed.

| Reference to Laws, Rules, and Regulations   | Non-compliance  |
|---|---|
| (a.) Establishments code of the Democratic Socialist Republic of Sri Lanka Section 13.3 of Chapter ii | An acting appointment should be made until a permanent appointment is made as a temporary measure. Nevertheless, two officers had been appointed as acting basis for the Accountant Post and the Book Keeper post of the fund since 2012 and 2010 respectively. |
| (b.) Financial Regulation of the Democratic Socialist Republic of Sri Lanka                           |   |
| (i) Financial Regulation 110  | A register for losses and damages had not been maintained.  |
| (ii) Financial Regulation 396   | Action in terms of financial regulation had not been taken in respect of 17 cheques totaling Rs.179,138, issued but not presented to the bank relating to 3 bank accounts and lapsed for more than 6 months.  |
| (c.) Treasury Circular No.IAI/2002/02 dated 28 November 2002  | A register of fixed assets had not been maintained for computers and software.  |

## 3. Financial Review

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### 3.1 Financial Results

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According to the financial statements presented, the financial result of the Fund as at 31 December 2014 had been a deficit of Rs.127,823,734 as compared with the deficit of Rs. 59,365,788 in the preceding year thus observing a deterioration of Rs.68,457,946 or 115 per cent in the financial results of the year under review as compared with the preceding year. Even though the cost of sales had decreased by Rs.91,316,313 the decrease of revenue of the year by Rs.151,443,765 had mainly attributed to this deterioration.

### 3.2 Legal cases initiated against or by the Fund

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The following observations are made.

- (a) Ten cases had been filed by the management in the court of law against 10 factories to recover a sum of Rs.9,409,291 and a case had been filed in the District court of Colombo in respect of a cash fraud of Rs.250,019 in the Marketing Division of the Fund.

- (b) A case had been filed against an external institution to recover a sum of Rs.19,211,584 due to the Fund and the decision was given in favour of the Fund on 20 June 2014 but the defence had made an appeal in the commercial high court of Colombo on 20 August 2014.
- (c) Employees had filed 4 cases in the Labour Tribunal against the Fund.

#### 4. Operating Review

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##### 4.1 Performance

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The following observations are made.

- (a) Factory Profits/ Losses
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The Fund owned 14 factories out of which only 10 factories were in operation in the year under review. The loss sustained by those factories in the year under review (except head office expenses) amounted to Rs.115,482,937. When it compared with the preceding year, the loss had increased by Rs.69,730,592 or 152 per cent. Profits/ losses incurred by those factories under operating condition from the year 2010 to the end of the year under review are given below.

| Factory<br>----- | Profitability<br>-----<br>'000' |               |               |               |               |
|------------------|---------------------------------|---------------|---------------|---------------|---------------|
|                  | 2014<br>-----                   | 2013<br>----- | 2012<br>----- | 2011<br>----- | 2010<br>----- |
|                  | Rs.                             | Rs.           | Rs.           | Rs.           | Rs.           |
| Deniyaya         | (11,913)                        | (7,777)       | (7,349)       | (4,126)       | 1,054         |
| Walahanduwa      | (14,068)                        | 731           | (2,297)       | (3,312)       | 558           |
| Marawila         | (10,279)                        | (10,229)      | (6,108)       | (3,653)       | 158           |
| Elpitiya         | (13,482)                        | (3,409)       | (7,990)       | (16,604)      | (10,105)      |
| Raigamkoralaya   | (15,885)                        | (7,479)       | (7,579)       | 2,191         | 7,670         |
| Kothmale         | (9,683)                         | (6,933)       | (6,132)       | (8,901)       | (11,348)      |
| Keppitipola      | (5,628)                         | 5,421         | (1,285)       | (5,223)       | 1,239         |
| Passara          | (1,769)                         | 5,772         | 6,640         | 2,345         | 6,342         |
| Mahaweli         | (10,054)                        | (13,079)      | (899)         | 245           | (2,738)       |
| Deraniyagala     | (22,722)                        | (8,770)       | (3,989)       | -             | -             |
|                  | -----                           | -----         | -----         | -----         | -----         |
| Total            | (115,483)                       | (45,752)      | (36,988)      | (37,038)      | (7,170)       |
|                  | =====                           | =====         | =====         | =====         | =====         |

The following observations are made in this regard.

- (i) Eventhough Walahanduwa, Keppetipola and Passara factories had earned profits in the preceding year, all 10 operating factories had incurred losses in the year under review. Similarly, the Kotmale Tea factory since 2010 and the Deraniyagala factory, opened in the year 2012 had continuously incurred losses.
- (ii) Eventhough tea leaves had been purchased by paying high prices in order to minimize factory losses with the objective of purchasing more tea leaves, this objective had not been achieved and only the increase in cost had been incurred due to incurring additional cost.

**(b) Tea Production**

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The following observations are made in this regard.

|   | <b>2014</b> | <b>2013</b> | <b>Increase/ (Decrease)</b> | <b>Percentage of different</b> |
|---|-------------|-------------|-----------------------------|--------------------------------|
|   | -----       | -----       | -----                       | -----                          |
| Raw Tea purchased Quantity (kg)                                     | 8,084,257   | 10,118,528  | 2,034,271                   | 20.10                          |
| Tea manufactured (kg)   | 1,697,683   | 2,123,142   | 425,459                     | 20.40                          |
| Cost of production per kg Rs.                                       | 435.27      | 471.11      | 35.86                       | 7.61                           |
| Net average selling price per kg                                    | 399.47      | 411.10      | 11.63                       | 2.91                           |
| Average selling price per kg at Colombo Tea Auction on location Rs. | 461.86      | 444.42      |                             |                                |

- (i) As compared with the preceding year, the quantity of raw tea leaves purchased by factories had decreased by 2,034,271 kg and the overall tea production in the factories had dropped by 20.04 per cent in the year under review. Eventhough tea production in Mawarala, Raigam Korale and Deraniyagala tea factories had increased, tea production of all the factories had decreased ranging from 18 to 53 percentages.
- (ii) The cost of production per kg of tea had increased by 7.61 per cent and the net selling price had decreased by 2.9 per cent. It was observed that the net selling price per kg of tea had been less than the cost of production of one kg of tea in all factories belonging to the Fund.

(iii) The overall average price of one kg of tea at Colombo tea auction in the last 5 years had observed a decrease as compared with the average selling price of the factories belonging to the Fund.

(c) According to the Action Plan for the year under review and the performance reports, the tea productions in the tea factories are as follows.

| <b>Factory</b> | <b>Targeted purchase of raw tea leaves as per Action Plan</b> | <b>Actual purchase of tea leaves</b> | <b>Targetted tea production as per Action Plan</b> | <b>Actual Tea Production</b> | <b>Percentage of progress</b> |
|----------------|---|--------------------------------------|--|------------------------------|-------------------------------|
| -----          | -----   | -----                                | -----  | -----                        | -----                         |
|                | (kg)  | (kg)                                 | (kg)   | (kg)                         |                               |
| Deniyaya       | 1,500,000   | 713,628                              | 322,500  | 146,651                      | 45.47                         |
| Walahanduwa    | 1,500,000   | 683,708                              | 322,500  | 141,814                      | 43.97                         |
| Mawarala       | 1,110,000   | 267,805                              | 238,650  | 55,382                       | 23.21                         |
| Elpitiya       | 1,500,000   | 497,958                              | 322,500  | 102,435                      | 31.76                         |
| Raigamkoralaya | 1,950,000   | 1,538,794                            | 419,250  | 316,688                      | 75.54                         |
| Deraniyagala   | 1,500,000   | 1,222,146                            | 322,500  | 250,966                      | 77.82                         |
| Kothmale       | 1,168,000   | 389,658                              | 251,100  | 80,351                       | 31.40                         |
| Keppetipola    | 1,800,000   | 965,544                              | 392,400  | 206,235                      | 52.56                         |
| Passara        | 1,650,000   | 948,651                              | 363,000  | 209,097                      | 57.60                         |
| Mahaweli       | 1,800,000   | 856,455                              | 387,000  | 188,064                      | 48.60                         |
| Total          | 15,478,000  | 8,084,257                            | 3,341,400  | 1,697,683                    |                               |

According to the Action Plan of the year under review, it was expected to purchase 15,478,000 kg of raw tea leaves during the year under review but only 8,084,257 kg of raw tea leaves or 52.23 per cent had been purchased. As such, the targeted tea production according to the action plan of the year under review amounted Rs.3,341,400 kg and the actual production was only 1,697,683 kg or 50.81 per cent. As considered factory wise performance, except Deraniyagala and Raigam Korale factories had ranged from 23 per cent to 58 per cent.

**(d) Domestic Tea Marketing Division**

Eventhough it was planned to market tea valued at Rs.6,794,010 according to the action plan during the year under review in the Domestic Tea Marketing division, the actual tea sales amounted to Rs.2,848,418, representing only 42 per cent of the target.

**(e) Fertilize Division**

The sales target of Fertilize during the year under review was 8,525 MT but the actual sales amounted to 1,440 MT or 16.89 percent only.

**(f) Welfare Division**  
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A loan of Rs.118,300,000 had been given to the factories of the fund during the period from 2000 to 2003 from the welfare fund of the members of Tea Small Holders, operated by the Tea Shakthi Fund. Nevertheless, those factories had not settled those loans even up to the end of the year under review. As the factories are running at losses continuously there was an uncertainty in settling the loan balance and the accumulated interest totalling Rs.50,968,658 up to the end of the year under review.

- (g) Dividends to 94,425 shareholders who owned shares valued at Rs.206,014,150 as at 31 December 2014 had not been paid after the year 2007 up to the year under review. Eventhough the vision of the Fund is to become an excellent institution dedicated to foster tea smallholders' economic and social existence by increasing the share capital values of member shareholders, that objective could not be achieved due to the above issues.

**4.2 Management Activities**  
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The following observations are made.

- (a) A formal lease agreement with the Kothmale Tea Factory belonging to the Mahaweli Authority operated under the Fund for 12 years had not been entered into. However, according to the decision No. අමප/07/1906/309/019 dated 21 June 2007 of the Cabinet of Ministers, the approval had been granted to vest this factory and land and the factory bungalow belonged to it by a transfer note but action had not been taken accordingly. As such a sum of Rs.5,084,970 had been paid as rent and penalties during the period from 2008 to 2014.
- (b) Action had not been taken to transfer the ownership of 9 motor vehicles belonging to the tea small holders societies, which had been shown in the accounts of the Fund at a cost of Rs.8,512,921.
- (c) In view of the weak management supervision, 6 plots of land, 18.59 purchase in extent had been encroached by an external party after being closed down the Balangoda factory. A case in the District court of Balangoda is being heard in this connection.
- (d) Without taking action to set off the economic service charge totalling Rs.1,403,526 payable for the year under review and the previous year against the balance of Rs.3,415,813 receivable from the Department of Inland Revenue it had been brought to accounts as a payable balance as at the end of the year.



### **4.3 Idle and Underutilized Assets**

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The following observations are made.

- (a) Eventhough a fertilize grinder for Rs.2,197,447 had been purchased in the year 2006 to mix fertilize at the fertilize stores complex of the Fund, it had been idle without being utilized as a result of mixing cost and the time spent thereon at a high level.
- (b) After the closure of the Balangoda factory, the official quarters and the toilet system had been dilapidated due to non-maintenance of buildings properly. The land valued at Rs.1,350,000 in which the Balangoda factory was located and the buildings valued at Rs.10,000,000 had been idle without being utilized for any purposes by the end of the year under review.
- (c) Eventhough a computer software system valued at Rs.2,435,000 had been purchased in the year 2010 in order to prepare consolidated accounts of the Head Office of the Fund and all factories, it had not been utilised for the preparation of accounts even by 20 June 2016.

### **4.4 Apparent Discrepancies**

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Action had not been taken to identify and to recover the value of shortage of tea stock at the Elpitiya tea factory from the parties responsible thereon.

### **4.5 Commencement of projects in the lands not formally vested**

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Eventhough the value of factory lands stated in the accounts as Rs.62,391,999, the Fund had not taken action to vest the ownership of those lands up to 30 June 2016.

### **4.6 Personnel Administration**

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The approved and actual cadre of the Fund as at the year under review stood at 90 and 60 respectively and as such there were 30 vacancies which included 14 staff officers posts. The approved and actual factory staff stood at 199 and 79 respectively existing 120 vacancies which included 19 Technology officers representing 53 per cent vacancies.

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

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### **5.1 Presentation of Financial Statements**

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Even though the financial statements should be presented to the Auditor General within 60 days after the closure of the financial year in terms of Paragraph 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the financial statements for the year under review had been presented to audit on 29 April 2016. Further, the draft annual report had not been presented to audit even by 20 October 2016.

## **5.2 Budgetary Control**

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According to the budget of the Fund, variances between the budgeted revenue and expenditure and actuals were observed ranging from 39 per cent to 100 per cent, thus the budget had not been made use of an effective instrument of management control.

## **6. Systems and Controls**

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

- (a) Accounting
- (b) Financial Control
- (c) Factory Operations
- (d) Utilisation of Assets
- (e) Vehicles Control
- (f) Stock Control