Northsea Limited – 2015/2016

The audit of the financial statements of the Northsea Limited ("the Company") for the year ended 31 March 2016 comprising the statements of financial position as at 31 March 2016 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.

This report is issued in terms of Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") 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 Board 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

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. 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 the risks of material misstatements of the financial statements, whether due fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company'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 Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

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

(a) According to the paragraph 39 (a) and (b) of the Sri Lanka Accounting Standards (LKAS) 20 – Accounting for Government Grant and Disclose of Government Assistance; the Company should disclose the accounting policy including the methods, nature and extent of Government Grants recognized in the financial statements. However, the Company had not disclosed the accounting policy, the nature and extent of Government Grants recognized in the financial statements for the reporting period under review. Further, brought forwarded Government Grants amounting to Rs.72,478,172 and Rs.14,029,065 had been amortized against retained earnings and other income during the reporting period under review without considering the nature of the grants.

(b) The Company had taken over the machinery wroth Rs.6,300,000 from the Cey-nor Foundation in the financial year 2000/2001. However, such machinery had not been recorded as an asset and depreciated accordingly. In the meantime, this was recorded as an asset in the financial year 2015/2016 without being assessed the useful economic life of such asset.

(c) Brought forwarded lease interest in suspense balance of Rs.3,666,704 had been treated as an expense in the year under review instead of being rectified the suspense account balance. As a result, profit for the year under review had been understated by similar amount.

(d) Suspense account balance of Rs.1,267,032 had remained in books of accounts of the Company without being rectified even in the year under review.

(e) The Company had not convened an Extraordinary General Meeting in terms of Section 220 of the Companies Act, No. 07 of 2007, even though the net assets of the Company reached to a negative balance of Rs.52,144,084 at the end of the accounting period under review. It is indicating that the ability of the Company as a going concern is in doubt.

(f) LKAS 01 - Presentation of Financial Statements: According to the provisions in the Standard, an entity shall prepare its financial statements on accrual basis. However, in contrary to that the Company has recognized its other income on cash basis. Further, the Company had failed to disclose the comparative information in the statement of changes in equity and statement of cash flows as requested by this Standard.

(g) LKAS 17 – Leases: The followings details had not been disclosed in financial statements for the reporting period under review.

    (i) Reconciliation between the total future minimum lease payments and their present value as at the end of the reporting period.

    (ii) The total future minimum lease payments as at the end of the reporting period.

(h) LKAS 19 of Employee Benefits; The defined retirement benefit obligations should be measured by using Actuarial Valuation Method. However the Company had not applied this method for the measurement of provision for Gratuity. Further, no plan asset had been established by the Company in order to mitigate the future obligations of the retirement benefits.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Northsea Limited as at 31 March 2016, and its financial performance and its cash flows for the reporting period then ended in accordance with Sri Lanka Accounting Standards.

2.1.2 Report on Other Legal and Regulatory Requirements

As required by Section 163 (2) of the Companies Act No. 07 of 2007, I state the following;

(a) The basis of opinion and scope and limitations of the audit are as stated above.

(b) In my opinion

- Except for the possible effects of the matters described in Basis for Qualified Opinion paragraph, I have obtained all the information and explanations that were required for the audit and as far as appears from my examinations, proper accounting records have been kept by the Company.

- The financial statements of the Company comply with the requirements of Section 151 of the Companies Act No.07 of 2007.

2.2 Accounts Receivable and Payable

The following observations are made.

(a) Thirty debtor balances aggregating Rs. 11,631,108 were remained outstanding for more than one year without being recovered even as at the end of the year under review.

(b) Two loan balances aggregating Rs. 3,000,000 obtained from Government institutions and seven creditor balances aggregating Rs.25,908,608 had remained outstanding for over 10 years and 01 year respectively without being settled.

2.3 Non - compliance with Laws, Rules, Regulations and Management Decision etc.

The following instances of non-compliance with Laws, Rules, Regulations and Management Decisions were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a) Section 21(1) and 67(f) of the Value Added Tax Act No.14 of 2002.	The Company has neither paid Value Added Tax (VAT) amounting to Rs. 93,101,473 nor furnished VAT returns to the Department of Inland Revenue since the year 2010. Therefore, a sum of Rs.30,983,483 had to be paid as penalty thereon as at the end of the year under review.
(b) Section 06 of the Economic Service Charge (ESC) Act No. 13 of 2006.	ESC for the Year of Assessment 2015/2016 amounting to Rs. 3,141,513 had not been remitted to the Department of Inland Revenue even up to 05 December 2017 although it should be remitted on or before 20^{th} of the following month of each quarter.
(c) Inland Revenue Act 10 of 2006.	
(i) Section 25, 26 and 32	Although the Company has sustained an accounting loss from its business operations, it is required to calculate the taxable profit or loss for tax purpose. However, loss for the year under review had not been adjusted for tax purpose.
(ii) Section 106	The Company had failed to submit the returns on income tax to the Department of Inland Revenue within the due date.
(iii) Section 136	Withholding tax on interest income had not been adjusted under tax credit.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company had resulted in a net loss of Rs.77,646,604 for the year under review as compared with the corresponding net loss of Rs.51,232,870 for the preceding year, thus indicating a further deterioration of Rs.26,413,734 in the financial results of the year under review. Increase of cost of sales and factory operating cost and recognized the lease interest in suspense as expenditure for the year under review were the main reasons attributed for this deterioration.

3.2 Analytical Financial Review

The following observations are made.

(a) Revenue for the year under review had declined by 45 per cent as compared with the previous year.

(b) Total non-current assets of the Company had decreased from Rs. 201.67 million in the preceding year to Rs.189.48 million in the year under review while the long term liability had increased from Rs.42.663 million in the preceding year to Rs.69.165 million in the year under review.

(c) Negative Gross Profit Ratio of the Company has further deteriorated from 3.7 per cent in the preceding year to 24 per cent in the year under review. This has indicated that Company even could not recover its cost of sales from its total revenue.

4. Accountability and Good Governance

4.1 Presentation of Financial Statements

In terms of Section 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the financial statements together with the draft annual report should be presented to the Auditor General within 60 days after the closure of the year of accounts. However, the financial statements for the year under review had been presented to audit only on 10 January 2018.

4.2 Internal Audit and Audit and Management Committee

No Audit Committee Meeting had been held by the Company during the year under review in terms of Department of Management Audit Circular No. DMA/cir-edit/2016 dated 28 January 2016. Further, the internal audit had not been conducted to ensure efficient operation of the Company and Factories belong to the Company.

5. Systems and Controls

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

Areas of System and Control	Observations
(i) Control over Debtors and Creditors	Prevailing of long outstanding balances of debtors and creditors.
(ii) Financial Control	Existence of un-cleared suspense balances for more than several years in the books of account of Company.
(iii) Maintenance of General Ledger	Opportunity for creation of unauthorized chart of accounts.