Lanka Sathosa Limited – 2015

The audit of financial statements of the Lanka Sathosa Limited for the year ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 and the statement of comprehensive income, statement of changes in equity and cash flow statement, 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. My observations on the functionality of the Company in the year under review which I consider should be presented in Parliament in terms of Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka appear in this report. In carrying out this audit, I was assisted by a firm of chartered accountants in public practice

1.2 Management's Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control 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 conducted in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000-1810).

1.4 Basis for Disclaimer of Opinion

(a.) Going Concern

The cumulative deficit of the Company amounted to Rs. 3,927,414,904 as at the date of reporting, and the value of current liabilities in excess of the current assets amounted to Rs. 3,734,029,192. It was further observed that the Company had faced a serious loss of capital as stated in Section 220 (1) of the Companies Act, No. 07 of 2007. Due to such reasons, the capability of the Company to manage the liabilities through its assets , and the going concern of the Company remained doubtful.

(b.) Property, Plant and Equipment

----

i. Due to failure in properly maintaining a Register of Fixed Assets for the Property, Plant and Equipment mentioned in financial statements, the completeness, physical existence, value, and the accuracy of the deprecation thereof could not be examined in audit. An opening balance of Rs. 335, 204,308 relating to a value of unidentified and unreconciled assets had been included therein. Furthermore, it was observed that a concrete methodology of internal control relating to Property, Plant and Equipment including systematic implementation of a physical verification method, identification of impairment losses if any, and adjusting the value of Property, Plant and Equipment accordingly, had not been formulated and implemented.

ii. Documentary evidence for the verification of ownership or lease rights of the lands used by the Company, had not been made available to Audit. Hence, it was not possible to specifically determine or predict the operating risks and the legal repercussions likely to occur.

iii. Cost on capital works in progress relating to the two projects in Kilinochchi, and Welisara, had been capitalized in the year under review. However, the certificates on completion of work issued by a qualified person relating to the said two projects had not been available. Hence, the values of Rs. 255,223,652 and Rs. 97,222,803 capitalized for the said projects respectively, and the adequacy in the retention and issue of the contractor's retention money, could not be examined or certified.

(c.) Inventory/Sales Cost/Trade Payable

It was observed that the non-availability of a fully-linked automated Information System had been the main obstacle faced by the Company in recording and reporting the daily transactions. More than 2/3 of the transactions performed at the outlets had been brought to accounts manually. As a result, inventories and purchases of those outlets had been entered into the general ledger through journal notes. As spreadsheets had been used in the process of putting notes manually, the weaknesses inherent thereto such as, internal errors, omission of data, repetition of the same note, and over/understatement of values, were observed. Adjustments with significant values made through journal notes by the end of the year were seen in consequence thereof. Some of the instances in which such deficiencies were observed, are as follows.

(i.) An auditor had not been appointed by the Company to supervise the physical verification of stocks. The inventories valued at Rs. 7,353,860,990 as at 31 December 2015 could not be verified even through alternative methods.

(ii.) The sales cost shown in the financial statements included significant adjustments of accounts such as, a net deficit of stocks amounting to Rs. 320,707,151, other stock variance of Rs. 5,260,590,631 arising in the comparison of ledger balance and physical balance, and rectification of the overstatement of import creditors valued at Rs. 1,472,412,039. In addition to that, no reports had been generated by the system in order to verify and ascertain the purchases made in the year under review.

(iii.) The management had involved in a process by 15 February 2018 for preparing reports in order to identify and verify the purchases and trade creditors relating to the year. As a result thereof, the Audit could not decide as to whether any adjustment had been necessary in respect of trade balances payable and inventories, and the overall impact on the profitability and financial position of the Company.

(iv.) The internal control being maintained at present relating to reporting, maintaining and inventorying the items, does not provide sufficient information such as, number of items purchased, cost per each item of the inventory, movement of inventory items (receipts and issues), and the inventory balance for a given period, thus posing an extensive operating risk to the Company. Furthermore, as a result thereof, it will be difficult to identify the actual variation, excesses and shortages if any, and identification and rectification of losses incurred due to misappropriation of inventory items and changes in Government policies. It was observed in accordance with the aforesaid matters that the internal control on the management of inventory was insufficient. Hence, the accuracy, completeness, and existence of the inventory value could not be relied upon.

(v.) The methodology being followed by the Management for evaluating the inventory does not comply with the requirements mentioned in the Sri Lanka Accounting Standard under "Inventory". Owing to that non-compliance, the likely financial impact on the sales cost and current assets shown in the financial statements, could not be either decided or quantified.

(vi.) It was observed that a considerable amount of stocks returned by the sales outlets of the Company to be sent back to the suppliers due to being expired, had been stored at the stores. However, the Company had not evaluated the value or quantity of those stocks, nor had the stocks been brought to accounts by the end of each year. According to an approximate estimate made by the store keeper, the value of that stock amounted to Rs. 164,235,969 as at 15 February 2018.

(d.) Under-remittances

A value of Rs. 60,987,712 spent on daily expenses of the sales outlets had been shown as under-receipt of remittances under the current assets. The Company had failed to identify the expenses according to the nature of expense incurred by the sales outlets, and account those expenses in accordance with the relevant accounts. As a result thereof, the loss sustained by the Company had been understated by that amount whereas the current assets had been overstated by the same value.

(e.) Financial Control of the Sales Outlets

The account balance of Rs. 260,385,136 shown under "cash in hand" in the financial statements could not be examined by following any alternative methodology due to non-availability of schedules and verifications relating thereto. As such, it was not possible to satisfy with the accuracy, existence, and completeness thereof.

(f.) Documents relating to the advance of Rs. 242,600,501 paid to the clearance representatives in the year 2014 in regard to the import of rice, had not been made available even up to 15 February 2018. As such, it was not possible to examine the settlement of expenses relating to the advances paid.

(g.) Balances with Significant Values Pertaining to the Connected Parties

According to the books of accounts of the Company, the balance payable to the Co-operative Wholesale Establishment as at 31 December 2015 amounted to Rs. 64,080,024. However, the Company received a letter from the Co-operative Wholesale Establishment requesting that the sum of Rs. 279,345,614 receivable from the Company as at that date was accurate. Accordingly, the difference between the balances of the books of the Company and Co-operative Wholesale Establishment amounted to Rs. 215,265,590. The said difference was not reconciled, nor was explained. As such, it was not possible to satisfy with the balance shown in the financial statements as being payable to the Co-operative Wholesale Establishment.

(h.) Import of Rice

Attention should be drawn on my observations included in the special audit report furnished to the Parliament on 30 December 2016 relating to the import of rice by the Lanka Sathosa Company in the years 2014 and 2015.

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the significance of the matters described in paragraph 1.4 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 these financial statements.

2.2 Report on the Other Legal and Regulatory Requirements

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

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

(b.) In my opinion;

- I have obtained all the information and explanations that were required for the audit and as far as appeared from my examination, proper accounting records have been kept by the Company except for the effect of the matters stated in the paragraph - Basis for Disclaimer of Opinion.

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

(c.) Action had not been taken in compliance with the provisions set forth in Section 220 of the Companies Act.

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

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

Reference to Laws, Rules, Regulations and Management Decisions		Non-compliance
Financial statements of the Democratic Socialist Republic of Sri Lanka		
(i.)	Financial Regulation 395 (d)	A Bank Reconciliation Statement should be prepared as at the end of each month, before the 15th of following month in regard to the nature of each transaction. However, Bank Reconciliation Statements for the year under review relating to 07 current accounts had not been prepared as at the due date.
(ii.)	Public Enterprises Circular, No. PED/1/2015, dated 25 May 2015,	A transport allowance of Rs. 730,833 had been paid by the Company in the year under review upon approval of the Board of Directors for 12 officers not entitled for official vehicles in terms of the Circular.

2.4 Transactions not Supported by Adequate Authority

A sum of Rs. 570,000 had been paid as professional allowance to 08 officers of the Company in the year under review only under the approval of the Board of Directors. However, approval of the Treasury had not been obtained in that connection in terms of Section 9.7 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Company for the year under review had been a deficit of Rs. 1,945,253,021 as compared with the corresponding deficit of Rs. 3,460,051,129 for the preceding year, thus indicating a decrease of 44 per cent or Rs. 1,514,798,108 in the financial result of the year under review as compared with the preceding year. The increase in gross profit by Rs. 4,920,908,894 despite the increase in stock shortages and damages, and expenditure on interest by sums of Rs. 1,759,964,865 and Rs. 1,031,229,919 respectively, had mainly attributed to the said decline in the deficit.

The analysis on the financial results for the year under review and 04 preceding years indicated that the net profit of the Company for the year 2010 amounting to Rs. 37,867,416 had increased to Rs. 1,156,456,272 by the end of the year 2013 with fluctuations annually incurring losses of Rs. 3,460,051,129 and Rs. 1,945,253,021 in the years 2014 and 2015 respectively. However, when the employee remuneration, taxes paid to the Government, and depreciation were adjusted to the financial result, the contribution had increased from the year 2010 up to the year 2013, but in the years 2014 and 2015, the contribution had recorded the minus values of Rs. 1,922,368,825 and Rs. 42,040,870 respectively.

3.2 Analytical Financial Review

Considering the profitability ratios of the Company in accordance with the financial statements presented, the gross profit ratio of the year 2014 being 1.08 per cent had increased to 18.74 per cent in the year 2015 whilst the net profit ratio being the minus value of 11.56 per cent had increased to the minus value of 6.95 per cent in the year 2015. Furthermore, the current ratios had been 0.78 and 0.73 whilst the quick ratios had been 0.14 and 0.2 for the preceding year and the year under review respectively, thus observing higher level of liquidity ratios. As such, it was observed that issues relating to working capital would arise.

4. Operating Review

4.1 Performance

4.1.1 Planning

In terms of Section 1 of Paragraph 5 of the Public Finance Circular, No. 01/2014, dated 17 February 2014, the Company should have prepared a Corporate Plan with a short-term and long-term vision in accordance with strengths, weaknesses, opportunities, and restrictions of the business by separately identifying the development activities executed by the Company for the Government along with the commercial affairs in the business realm. However, a Corporate Plan had not been prepared for the year under review in such a manner.

Moreover, a Business Plan had not been prepared as well by including the commercial activities to be executed in the ensuing financial year in terms of Section 2 of Paragraph 5 of the aforesaid Circular.

4.1.2 Functionality and Review

As a Corporate Plan together with an Action Plan in accordance therewith, and a Performance Report for the year under review had not been prepared in view of achieving the objectives of the Company, the progress in achieving the objectives of the Company, could not be examined in audit.

4.2 Management Activities

A loss of Rs. 10,108,720 had been identified to be claimed as insurance indemnity with respect to 36 burglaries committed at sales outlets of the Company in the year under review. However, the value of indemnity recovered in that connection amounted to Rs. 3,589,822 only. Due to failure in accurately calculating the losses on stocks owing to deficiencies in the internal control relating to stocks, a situation in which indemnity could not be obtained had arisen. Action had not been taken as well to recover the losses by identifying the parties responsible for the relevant losses.

4.3 Staff Administration

The approved cadre of the Company had been 3075, but the actual cadre stood at 3192 as at 31 December 2015 with 233 and 350 posts remaining vacant and excess respectively in the approved cadre. An additional staff of 350 had been recruited sans Treasury approval by the end of the year under review in the wake of the growing number of sales outlets of the Company.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

In terms of Public Enterprises Circular, No. PED/12, dated 02 June 2003, the annual financial statements and the draft annual report should be furnished to the Auditor General within a period of 60 days from the close of the year of finance. However, the financial statements of the year under review had been furnished on 10 April 2018 and the draft annual report had not been furnished.

5.2 Procurements

Buildings belonging to private parties had been selected for maintaining the sales outlets and stores of the Company in the year under review by deviating from the Government Procurement Guidelines- 2006, and a sum of Rs. 431,909,843 had been paid thereon whilst paying a sum of Rs. 7,884,442 for an institution supplying vehicles.

5.3 Unresolved Audit Paragraphs

In terms of Section 9.2 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003, an organizational structure had not been approved in accordance with the approved cadre of the Company whilst a Scheme of Recruitment had not been approved in terms of Section 9.3. Furthermore, recruitments and promotions had been made improperly.

6. Systems and Controls

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

Areas of Systems and Controls	Observation
a) Procurement	Failure to follow the provisions of the Government Procurement Guidelines.
b) Financial Control	Failure to prepare the bank reconciliation statements accurately and on time.
c) Human Resource Management	Non-availability of an approved Scheme of Recruitment, and making recruitments and promotions improperly.
d) Control of Assets	(i.) Failure to accurately maintain the stock reports. (ii.) Failure to accurately maintain the reports relating to fixed assets.
e) Contract Administration	Commencing contracts at lands of which the ownership had not been taken over.