

Kulubowitiyana Tea Factory Limited – 2015/2016

The audit of financial statements of the Kulubowitiyana Tea Factory Limited for the year ended 31 March 2016 comprising the statement of financial position as at 31 March 2016 and the profits or losses and other comprehensive income statement, 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. My observations on the performance of the Company of the year under review, which I consider should be tabled in Parliament in terms of Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka, appear in this report.

1.2 Board of Directors' 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 as the Board of Directors 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 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 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 management, as well as evaluating the overall presentation of 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 Establishment and Ownership of the Company

Kalubowitiyana Tea Factory Limited is a Limited Liability Company incorporated under the Companies Act, No.17 of 1982 and then re-registered under the new Companies Act, No.7 of 2007. This is a fully Government owned company and the sole shareholder of the Company is the Secretary to the Treasury.

1.5 Basis for qualified Opinion

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 Kalubowitiyana Tea Factory Limited as at 31 March 2016 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

2.2.1 Sri Lanka Accounting Standards

The following observations are made.

(a) **Sri Lanka Accounting Standard 16**

The assets costing Rs.222,062,063 had been fully depreciated as the useful life of non-current assets had not been reviewed annually. However, they had still been in use. Accordingly, action had not been taken to revise the estimated error in terms of Sri Lanka Accounting Standard 8.

(b) **Sri Lanka Accounting Standard 19**

(i) Even though actuarial gains or losses recognized at the re-measurement of the Employee Benefits Liability should be shown under other comprehensive income, it had not been so done.

(ii) The Accounting Policy for recognition of actuarial gains and losses in respect Employee Benefits and matters such as discount rate, rate of return on plan assets and rate of salary increases which should be used as basic actuarial assumptions as at the end of the reporting period, had not been properly disclosed.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) A sum of Rs.23,229,000 recorded in the financial statements as treasury grants received in preceding years had been written off in the year under review and shown as other income in the statement of comprehensive income. As such, the net loss of Rs.13,413,472 of the year had converted into a net profit of Rs.9,815,528.

- (b) A total sum of Rs.6,194,940 spent for painting and repairing of buildings of the Hiniduma Hills Tea Factory obtained on lease basis in the year 2012/2013 had been capitalized under buildings and a sum of Rs.1,238,988 had been written off against the profit as depreciation of the year under review.
- (c) Action had not been taken to eliminate the cost of the tea dryer of the Derangala Tea Factory, which was disposed of for Rs.1,000,000, in the year under review from accounts.
- (d) The deferred tax for the year under review had not been adjusted in the financial statements by the Company.

2.2.3 Unexplained Differences

The following differences were observed between the Ledger Accounts of the year under review and **corresponding** schedules presented.

Description	Balance according to the Ledger Account	Balance according to the Schedule	Difference
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	Rs.	Rs.	Rs.
Distress Loans	10,477,937	10,641,513	163,576
Sundry Creditors Balances -			
-Derangala	1,565,607	1,855,185	289,578
-Kalubowitiyana	2,923,092	2,939,644	16,552

2.2.4 Lack of Evidence for Audit

Evidence indicated against the following items had not been made available to Audit.

Item	Value	Evidence not made available
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	Rs.	
Painting Activities of the Hiniduma Tea Factory	6,194,940	} Procurement File
Fertilizer Procurements	21,911,343	
Treasury Grants	23,229,000	Particulars on the objective for granting, the year and expenses incurred thereof
Debtors Balances	266,835	} Detailed schedules
Pre-payments	313,626	

2.2.5 Suspense Account

Balances of Suspense Accounts amounting to Rs.56,244 and Rs.474,296 had been brought forward under Debtors and Creditors respectively over a period of 05 years **without settling them.**

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) A sum of Rs.1,317,107 or 24 per cent out of the receivable balance of Rs.5,551,518 of the Kalubowitiyana Tea Factory and a sum of Rs.1,454,517 or 32 per cent out of the receivable balance of Rs.4,554,872 of the Derangala Tea Factory as at the end of the year under review, had exceeded 5 years.
- (b) A sum of Rs.1,687,078 out of the loan payable balance of Rs.31,197,181 of the Kalubowitiyana Tea Factory as at the end of the year under review and a sum of Rs.2,841,646 or 26 per cent out of the payable balance of Rs.11,121,058 of the Derangala Tea Factory as at that date had exceeded 05 years.
- (c) Even though there was a methodology for making payments to fertilizer suppliers after recovery of the amount given to tea owners for fertilizer from the amount payable to the tea owners for supply of tea leaves **by the Company**, information on 4 **fertilizer creditors balances** valued at Rs.1,821,000 was not available with the Company. Moreover, 04 fertilizer **creditors balances valued at Rs.1,653,611** older than 03 years was being brought forward without settling them.

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

The following instances of non-compliance with laws, rules, regulations, etc. were observed.

Reference to Laws, Rules, Regulations, etc.	Non-compliances
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Companies Act, No.07 of 2007	
(a) Section 133	Even though the Annual General Meeting should be held during a period not later than 6 months after the balance sheet date and not later than 15 months after the previous Annual General Meeting, a last Annual General Meeting had not been held after the year 2011/2012.
(b) Section 150	Even though financial statements should be presented within six months or within such extended period as determined by the Registrar after the balance sheet date, action had not been so taken.

(c) Section 166

Even though the Board of Directors should prepare an Annual Report within six months after the balance sheet date of the Company for the period ending on that date, it had not been so done.

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 net profit of Rs.9,815,528 as compared with the corresponding net profit of Rs.13,137,312 for the preceding year, thus indicating a deterioration of Rs.3,321,784 or 25 per cent in the financial result of the year under review as compared with the preceding year. The increase in the financial expenditure by Rs.5,543,517 in the year under review as compared with the preceding year, had been the main reason for the above deterioration.

An analysis of financial results of the year under review and 04 preceding years revealed a continuous net profit. Nevertheless, deterioration in that profit was observed annually. However, taking into consideration the employees' remuneration, depreciation on the non-current assets and Government tax, the contribution of the Company had been a favourable value. Even though the contribution of the year 2012/2013 had decreased as compared with the year 2011/2012, subsequently, it had regularly improved, thus indicating an improvement of 11 per cent in the contribution of the year under review as compared with the preceding year.

3.2 Profitability Ratio Analysis

The gross profit ratio of the year under review and the preceding year was 1.079 per cent and 1.74 per cent respectively. Even though the cost of sale of the preceding year had been 94 per cent from the income of sales, it had been 99 per cent in the year under review and this had been the main reason for the deterioration of this ratio. The net profit ratio of the year under review and the preceding year had been 1.26 per cent and 2.3 per cent respectively and the decrease in the net financial income by 71 per cent of the year under review as compared with the preceding year had been the main reason therefor.

3.3 Legal Action Initiated Against / by the Company

The following observations are made.

- (a) A case had been filed in the Kotapala Labour Tribunal against the Company in the year 2007 by two employees in respect of dismissal from the service and it had not been finalized even by the end of the year under review.

(b) A case had been filed in the Court of Appeal by the Department of Inland Revenue against the Company in respect of the judgement given by the Tax Appeals Commission stating that the basis of payment of income tax of the Company in the year 2010/2011 was correct.

4. Operating Review

4.1 Performance

The following observations are made.

(a) Tea Production

According to the information presented to Audit by the Company, the percentage of the production of made tea in 03 preceding years had been as follows.

Year -----	Tea Factory -----			Derangala -----			Hiniduma -----		
	Green Leaf -----	Made Tea -----	Percentage of Production of Made Tea -----	Green Leaf -----	Made Tea -----	Percentage of Made Tea -----	Green Leaf -----	Made Tea -----	Percentage of Production of Made Tea -----
	Kg	Kg		Kg	Kg		Kg	Kg	
2015/16	4,774,872	994,540	20.83	2,249,785	460,860	20.48	1,095,511	219,765	20.06
2014/15	4,446,200	943,706	21.23	1,539,562	315,854	20.52	834,380	171,751	20.58
2013/14	4,638,578	995,844	21.47	1,386,298	281,666	20.32	731,251	146,031	19.97

According to the criteria of the Tea Board, out of 100 Kilogrammes of used green leaf, at least a production of 21.5 Kg of made tea should be maintained. However, the tea production of two Factories of Derangala and Hiniduma was not at an optimum level during the period of 03 preceding years as given above and an accumulated loss of Rs.35,741,599 had occurred on green leaf during 04 preceding years.

(b) Cost of Production and Net Sale Average Price

According to the information presented to Audit by the Company, the cost of production and the net sales average price of 04 Factories during 03 preceding years had been as follows.

Name of the Factory	Cost of Production of Tea per 1 kg			Net Sales Average Price of Tea per 1 kg			Contribution of Tea per 1 kg		
	2015/16 Rs.	2014/15 Rs.	2013/14 Rs.	2015/16 Rs.	2014/15 Rs.	2013/14 Rs.	2015/16 Rs.	2014/15 Rs.	2013/14 Rs.
Kalobowitiyana	407.63	480.32	518.83	459.72	531.32	572.46	52.09	51.00	53.63
Derangala	430.72	503.67	525.53	413.50	470.60	516.14	(17.22)	(33.07)	(9.39)
Hiniduma	459.03	524.12	559.96	402.43	460.78	494.11	(56.60)	(63.34)	(65.85)
Menikdiwela	522.58	-	-	375.09	-	-	(147.49)	-	-

The following observations are made in this connection.

- (i) A cost over the net sales average price had been incurred for the production of 1 kg of tea in factories except the Kalubowitiyana Tea Factory during the period of 3 preceding years. As such, those factories had sustained losses continuously.
- (ii) As compared with the preceding year, the net sales average price of all factories had deteriorated.
- (c) **Capacity Utilization /Targeted Tea Production**

According to the Action Plan for the year under review, targets had not been included for the production of tea for each factory and according to the budget of the Company, the targeted and actual tea production and plant utilization in factories are as follows.

Factory	Targeted Tea Production according to the Budget	Actual Tea Production	Percentage of Variance	Production Capacity	Percentage of Underutilization
	Kg	Kg		Kg	
Kalubowitiyana	1,092,588	994,540	9	1,350,000	26
Derangala	542,084	460,860	15	485,000	5
Hiniduma	263,263	219,765	16	485,000	55
Menikdiwela	141,627	117,017	17	450,000	74

It was observed that the Kalubowitiyana and Hiniduma factories were functioning under capacity due to failure in obtaining sufficient green leaf for utilizing the full capacity.

(d) **Tea Nursery**

A tea nursery attached to the Derangala Tea Factory had been initiated in the year 2015 with a view to supplying quality tea plants and spent a sum of Rs.1,201,075. The following observations are made in this connection.

- (i) Even though the capacity of this commercial twig nursery stands at 100,000 plants, the total number of tea plants in the nursery by the date of audit stood at 54,517. As such, it represented only 54.52 per cent of the total capacity.
- (ii) Out of the number of plants in the nursery, 13,208 plants had perished and it represented 14.99 per cent of the total number of plants.

4.2 Procurement Procedure

The following observations are made.

- (a) Even though a sum of Rs.55,112,792 had been spent for the development of the Menikdiwela Tea Factory obtained on lease basis, so as to use it for production activities, provisions in the Government Procurement Guidelines had not been followed therefor.
- (b) A sum of Rs.21,911,343 had been spent in the year under review for the purchase of fertilizer to be given to the suppliers of green leaf through the factories belonging to the Kalubowitiyana Tea Factory Limited without following the Government Procurement Guidelines.

4.3 Management Activities

The following observations are made.

- (a) Even though a sum of Rs. 50,000,000 had been paid as lease rent on 09 April 2015 for obtaining the Hiniduma Tea Shakthi Tea Factory and the Yatinuwara Tea Factory which was under construction, belonging to the Tea Shakthi Fund to the Company on 30 years' long term lease basis, the two parties had not entered into a formal agreement up to the date of the Audit Report.
- (b) According to the Notice of the Commissioner General of Lands, published in the Gazette Notification of the Democratic Socialist Republic of Sri Lanka dated 04 July 2014 in terms of Government Land Regulation No. 21(2) in respect of the land on which the Menikdiwela Tea Factory is located, it had been mentioned that sub leasing cannot be done before the lapse of a minimum period of 05 years from the date of leasing. Nevertheless, action had been taken to obtain this land to the Tea Shakthi Fund on lease basis mentioned above, before the lapse of 05 years of obtaining this land.

- (c) Even though quotations had been called for by publishing newspaper advertisements in 3 instances from the year 2015 to the year 2017 for the purchase of two Colour Separators for the Hiniduma and Menikdiwela factories, those bids had been cancelled and it had been decided to invite for bids for the fourth time as well. The oversight and inefficiencies occurred in the procurement process had been the main reasons for cancelling of bids.
- (d) An expenditure of Rs.1,897,386 had been incurred for the year under review and obtained a Colour Separator under Operating Lease Method to improve the quantity of tea produced in the Menikdiwela factory to a higher level and to obtain a higher price for tea based on that. However, a high price could not be obtained for tea as expected.
- (e) Even though payments of Rs.7,380,537 had been made in the year 2012 for repairs of the Tea Dryers of the Kalubowitiyana Tea Factory, a technical report on the repairs carried out by the service supplier had not been obtained. Those repairs had not been completed even by the end of the year under review and the amount paid had been brought to account as advances.
- (f) According to reports of the Landslide Studies and Services Division of the National Building Research Organization, it had been pointed out that the Menikdiwela Factory is located on a sharp sloped land with a valley, the upper part is unstable due to severe erosion and that cracks are observed on the walls in the buildings of the Factory. Attention had not been paid by the Company in this respect before investing funds thereon.

4.4 Personal Administration

The following observations are made.

- (a) An officer without educational or professional qualifications had been recruited on contract basis contrary to the approved Scheme of Recruitment for the post of Assistant Factory Officer of the Menikdiwela Tea Factory. Moreover, the approval of the Ministry and the Department of Management Services had not been obtained therefor.
- (b) Even though the approval of the Department of Management Services had been obtained for the recruitment of an officer for the post of the Menikdiwela Factory Manager in accordance with the approved Scheme of Recruitment in a proper and transparent manner, an officer who had not fulfilled the relevant educational qualifications, had been recruited for the post of Factory Manager on contract basis.
- (c) Even though the approved cadre of Junior Assistant Factory Officers stood at 10 for all factories, the actual cadre had been 19 and as such, the excess cadre was 9.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

In terms of Section 6.5.1 of Public Enterprises Circular No. PED/12 of 2 June 2003, the financial statements should be presented to audit within 60 days after the closure of the financial year. However, the financial statements for the year under review had been presented to audit on 08 February 2017.

5.2 Unresolved Audit Paragraphs

It had been directed at the Committee on Public Enterprises held on 27 February 2013 to recover the following receivable balances.

- (a) A loan amounting to Rs.10,000,000 had been granted in the year 2003 to BCC Lanka Limited on an interest rate of 22 per cent and on the basis of recovering it in 12 installments. The total sum recoverable as at the end of the year under review amounted to Rs.44,702,867 due to failure in the recovery of at least one installment.
- (b) The sum of Rs.789,461 receivable in the year 2009 from a Broker Company had been unrecovered up to the end of the year under review.

5.3 Internal Audit

The following observations are made.

- (a) According to the Observation Report No. MPI/IA/01/SI/02-2015 dated 23 June 2015 of the Internal Auditor of the Ministry, it had been shown that payments of Rs.4,290,000 had been made from the year 2011 to the year 2014 exceeding the maximum monthly rental payable for hired motor vehicles mentioned in Public Finance Circular No.353(5). Nevertheless, action had not been taken in this connection.
- (b) Even though an Internal Auditor had been appointed since 04 April 2016, a staff had not been attached.

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

Observations

Areas of Systems and Controls	Observations
(a) Accounting	Delays in presentation of accounts.
(b) Procurement Activities	Non-compliance with the Government Procurement Guidelines.
(c) Balances Receivable and Payable	Failure in recovery for a long time and non-settlement of balances.
(d) Financial Control	Payment of a large amount of interest on the bank overdraft.
(e) Factory Operations	Losses sustained by factories.
(f) Fixed Assets Management	Non-maintenance of a Register of Fixed Assets and unavailability of lease agreements for property obtained on lease basis.