

National Paper Company Limited -2016/2017

The audit of the financial statements of the of National Paper Company Limited for the year ended 31 March 2017 comprising the statement of financial position as at 31 March 2017 and the statement of profit and loss, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 comments and observations which I consider should be tabled in Parliament appear in this report

1.2 Responsibilities of Management for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

1.3 Auditors' 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 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 misstatement 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 these 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 Disclaimer of Opinion

My opinion is disclaimed based on the matters described in Paragraph 2.2 of this report

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the effect of the matters described in the Paragraph 2.2 of this report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. Accordingly, I do not express an opinion on the accompanying financial statements of the Company.

2.2 Comments on the Financial Statements

2.2.1 Non-compliance with Sri Lanka Accounting Standards

Even though the cost of lands and buildings should be identified separately in the financial statements in terms of Sri Lanka Accounting Standard No. 16, the cost of the lands and buildings under the property, plant and equipment of the Company totalling to Rs. 132,274,693 had not been identified separately

2.2.2 Accounting Deficiencies

The following observations are made.

- a. The annual loss had been overstated by Rs. 532,634 as provision for depreciation of motor vehicles of the Company had been calculated by exceeding the cost.
- b. When reconciling the opening balances of the general ledger as at 01 April 2016 with the balances indicated in trial balance of the company as at 31 March 2016, the management had failed to explain to the audit the total difference of Rs. 8,100,939,346, as Rs. 3,887,304,944 relating to 136 asset account balances, Rs. 3,770,750,351 relating to 218 liability account balances and Rs. 442,884,051 relating to 3 equity account balances.

2.2.3 Lack of Documentary Evidence for Audit

- a. Evidence had not been presented to the audit to verify 04 revenue account balances of Rs. 49,863,660, and 03 expenditure account balances of Rs. 95,447,434, and transactions and account balances totaling to Rs. 3,024,546,642 consisting of property, plant and equipment worth Rs. 484,423,303, closing stock worth Rs.121,020,606, trade receivables worth Rs. 87,755,556, other receivables worth Rs.465,449,058, cash and cash equivalents worth Rs. 38,005,467, interest-bearing loans worth Rs. 160,140,052, trade payables worth Rs. 134,645,393 and other payables worth Rs. 1,387,796,113.
- b. Even though information was requested by audit in relation to 35 payment and receipt transactions worth Rs. 3,932,433 and Rs. 6,600,000 related to the account number 164807 of the Bank of Ceylon during the investigation of the transactions carried out by the banks of the National Paper Company Limited related to the year 2016 / 2017, any information in that regard had not been submitted to audit. Even though information regarding 36 transactions relating to account number 2699996 had been requested, only copies of cheques relating to 27 of these transactions had been received by audit. However, information related to 9 transactions worth Rs.55,052,258 had not been submitted to audit. According to the said cheques, cash cheques amounting to Rs.11,342,643 had been paid to 16 persons, and 02 cheques totalling to Rs. 44,528,981 had been paid to the Commissioner of Labour and Rs.19,084,250 had been paid to the Employees Provident Fund through 2 cheques. However, the payment vouchers and any confirmation letter relating to those cheques had not been submitted to audit.

3. Financial Review

3.1 Financial Result

The operating results of the year under review was a loss of Rs. 46,888,937 as against the profit of Rs. 71,610,232 for the previous year. Accordingly, a deterioration of Rs.118,499,169 was observed in the financial result. This deterioration was mainly attributed to the decrease in the other income by Rs. 75,290,868 and increase in administrative expenses by Rs. 72,100,692.

4. Operating Review

4.1 Management Inefficiencies

The following observations are made.

- a. Although it is required to maintain accounting records and supporting documents that accurately record and explain the transactions of the company as per Section 148 of the Companies Act No. 07 of 2007, the competent authorities of the company had not taken steps to keep the accounting books and accounting evidence relating to the transactions and incidents relating to the accounting period.
- b. The electricity supply to the Valachchenai factory had been temporarily disconnected from 09 February 2015 due to non-payment of the outstanding electricity bill amounting to Rs.483,997,075 to be paid to the Ceylon Electricity Board as at that date, and due to non-availability of electricity supply, any production process had not taken place in the Valachchenai factory until June 2020. However, production activities of the factory had been resumed in July 2020 by obtaining the approval subject to the condition of paying the remaining electricity bill amounting to Rs. 122,004,390, after writing off the penalty interest of Rs. 361,992,685, in instalments within a period of six months after the lapse of a period of two years from the date of resumption of production activities of the Company by the letter of the General Manager of the Ceylon Electricity Board bearing No. EP/EE(COM)/CS/Bulk Supply dated 08 September 2022 and by the Cabinet Decision No. CP/20/0561/224/015 dated 26 March 2020. Accordingly, the paper company had paid Rs.10,000,000, out of the outstanding electricity bill of Rs. 122,004,390 as at 31 December 2023, and further the Paper Company had to pay a sum of Rs. 112,004,390.
- c. There had been 23 employees comprised of 09 employees recruited on permanent basis in head office of the Company from July 2020, and 12 employees recruited on contract basis and 02 employees recruited on daily wage basis, and there had been 126 employees at Valachchenai factory comprised of 06 employees recruited on contract basis and 120 employees recruited on daily wage basis. The total number of employees had been 149, and the approval of the Department of Treasury Operations had not been obtained for this staff so far.
- d. At the time of commencement of production activities at the Valachchenai paper factory, a loan of Rs. 40 million had been obtained from the People's Bank on 09 December 2020 with a Treasury guarantee, subject to a grace period of 06 months, with terms of repayment in 54 instalments over a period of 05 years. Furthermore, the Company had once again taken a loan of Rs. 100 million from People's Bank on 17 May 2021 for meeting the working capital requirements of the Valachchenai factory, subject to the repayment of it in a period of 05 years. This loan had been taken with the guarantee of the General Treasury at market interest rates and the National Paper Company Limited had not received any support from the line ministry, the Ministry of Industries.
- e. Although there were 02 main machines namely the Paper Machine and the Board Machine to be used for the production activities in the factory, only the Board Machine was being used. In the year 2020, when the production activities of the Valachchenai Paper Mill resumed and were continued, the company adopted the method of removing parts from the paper production machine and installing them in the board production machine for proper functioning in cases where the board production machine was not operating and mechanical faults were occurred. In this way, 08 main items from the paper production machine were installed to the board production machine and their value was Rs.34,433,059. Accordingly, the paper production machine was still inoperative to the extent that it could not be used for

any purpose even by 22 January 2024, the date of audit, and therefore the cardboard production had been hampered.

- f. The lessee had not paid Rs. 200 million, out of the Rs. 600 million, which had been agreed upon in terms of the agreement between the State Resources Management Corporation located at No. 561/3, Elvitigala Mawatha, Colombo 05 and the National Paper Company Limited, and the Perth Engineering and Maintenance PVT LTD, with a business address of No. 03/43, Ventnor Avenue, West Perth, Western Australia for a period of 30 years to rehabilitate and redevelop the Embilipitiya Factory in terms of the Lease Agreement No. 1037 dated 19 December 2011. Furthermore, the relevant Company had carried out production activities for a short period of time and then mortgaged the paper manufacturing machine owned by the Embilipitiya factory to Seylan Bank for a value of Rs. 418,483,037 and left the factory in the year 2012. The second lessee had to pay an amount of Rs. 120 million to the bank to settle this mortgage, and although the relevant lease agreement had been cancelled on 25 September 2014 by the Ministry of State Resources and Enterprise Development on the instructions of the Attorney General due to non-payment of rent instalments, necessary steps had not been taken to recover the rent of Rs. 42 million to be received for the three-year period from 19 December 2011 to 25 September 2014. Moreover, action had not been taken to specifically identify the parties that had entered in to the agreement by representing the National Paper Company to mortgage the manufacturing machinery to Seylan Bank and to recover the loss incurred by the Company from those parties responsible. The lessor had not taken any legal action regarding the breach of the agreement due to the cessation of production activities by Perth Engineering and Maintenance PVT LTD, which had entered into the agreement.
- g. The Ambilipitiya factory of the National Paper Company Limited had been leased out to KSPA Ambilipitiya Paper Mills (Private) Limited under the lease agreement dated 09 March 2022, on a consideration of Rs. 260 million for a period of 30 years. According to the agreement, production activities should commence within 18 months and during that period, the lessee should pay an annual rent instalment of Rs. 13,000,000 to the company. After the commencement of production activities, a value equivalent to 3% on the sales revenue should be paid as rent instalment as per the tax agreement. However, the relevant company had not yet commenced the production activities.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

- (i). Although the annual financial statements and draft annual reports should be submitted to the Auditor General within 60 days of the end of the accounting year as per Section 6.5.1 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, the financial statements of the National Paper Company Limited for the accounting year 2016/2017 had been prepared and submitted for audit on 02 February 2023.

5.2 Tabling of Annual Reports in Parliament

The annual report pertaining to the year under review had not been tabled in Parliament even by the date of this report.