Lanka Sathosa Ltd – 2016

The audit of the financial statements of the Lanka Sathosa Ltd ("the Company") for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows 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. In carrying out this audit I was assisted by a firm of Chartered Accountants in public practice.

Since the above mentioned financial statements for the year ended 31 December 2016 have not been submitted by 30 September 2018, the Auditor General has submitted a report to the Chairman of the Company on 14 November 2018, on the transactions for the year under review.

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 conducting the audit in accordance with Sri Lanka Auditing Standards.

1.4 Basis for Disclaimer of Opinion

(a) Going Concern

As at the reporting date, the Company's accumulated losses amounted to Rs.9,040,867,201 and current liabilities exceeded the current assets by Rs. 8,225,981,904. Further, it was observed that, the Company is running at a serious loss of capital situation as identified in Section 220 (1) of the Company's Act, No. 07 of 2007. These factors raise doubt that, the Company's capacity of meeting its liabilities by the assets of the Company and whether the Company will be able to continue as a going concern.

(b) Property, Plant and Equipment

(i) It was unable to examine the completeness, physical existence and accuracy of the values and related depreciation of property, plant and equipment as reported in the financial statements due to absence of completed register of property, plant and equipment. It is included unidentified and un-reconciled assets values, some of which represent opening balances amounting to Rs. 335,204,308. Also there is no process in place to recognize and capitalize assets on completion basis reported under work in progress. It was further observed that, a sound internal control procedure over property, plant and equipment such as carrying out of physical verification on regular basis, identification of impairment losses if any, and de-recognition of property, plant and equipment had not been designed and implemented.

(ii) The documentary evidence to substantiate the ownerships / leasehold rights of the lands occupied by the Company was not available for my verification. Hence, the operational risk exposure and the legal consequences arising therewith if any could not be ascertained nor quantified.

(c) Inventories / Purchases / Cost of Sales / Trade Payables

(i) My examination revealed that, the major drawback faced by the Company to record and report its day-to-day business transactions accurately, was due to the absence of a fully integrated and automated IT platform. The business transactions of the manual outlets that counts over two third (2/3) of the business transactions were captured into the accounts through manual accounting. As a result, particularly, the inventories and the purchases of these outlets were incorporated into the general ledger through journals. It was further revealed that, this manual exercise performed using spreadsheets had created inherent in-house errors such as omission in data, duplication and overstatements / understatements in values. As a result of this, there had been year-end adjustments significant in value passed through the journals. The shortcomings observed in few instances are given below.

(ii) It was not possible to observe the physical inventory counting as at the end of the year and even not satisfied alternative methods to verify the availability of inventory held at 31 December 2016 valued at Rs.3,975,959,505 due to absence of independent confirmations.

(iii) The cost of sales reported in the financial statements included significant accounting adjustments such as net stock shortages aggregated Rs. 379,701,902 and other stock variance arising when compared to physical and ledger balance amounting to Rs.4,106,723,701. In addition, no system generated reports were available to support and ascertain the purchases made during the year.

(iv) As of the date of my audit report, the management was in the process of generating reports to identify and ascertain the purchases and trade payables that correspond to purchases made during the year. As a result, in audit it was unable to determine whether, there were any adjustments found necessary to make relating to inventories and trade payables, and its financial impact to the profitability and the financial position of the Company as a whole.

(v) The accuracy and the completeness of trade payables as reported in the financial statements could not be vouched for nor relied upon as there were disagreements in balances confirmed by the suppliers as owing to them with that of the balances payable to them by the Company as at 31 December 2016. The difference identified therein amounts to Rs. 45,594,889 arising when compared to the total amount of balances i.e. Rs. 448,016,672 confirmed by the suppliers against the corresponding balances i.e. Rs. 402,421,783 shown as payable to them in the financial statements under trade payables. The total amounts of balances confirmed by the suppliers were in response to the confirmation of balances called on selected samples to a value of Rs. 498,854,944. Suppliers to a value of Rs. 96,433,161 were not responded.

(vi) The present practice in documenting, maintaining, and reporting of inventories did not provide sufficient information such as quantities and cost of each inventory items purchased, inventory movements in quantities (receipts and issues), and the inventory balance remaining at any given time, exposing the Company to greater operational risks. Further, this has resulted difficulty in assessing / detecting the actual variances, excesses and shortages if any, and the recovery action taken thereto by identifying inventory losses, policy changes etc. In light of the above it was observed the internal control relating to inventory management proved to be inadequate. Therefore, the accuracy, completeness and the existence of the inventory reported in the financial statements could not be relied upon.

(vii) A bulk amount of Rs. 14,729,648,431 has been transferred to manual outlets stock control account from the goods in transit account at the year end. The amount said to be the value of stock transferred to the manual outlets from the warehouses during the current year. However, documentary evidence such as transfer notes, the quantities and the description of the stock items transferred to each manual outlet and a summary statement indicating the value of stock transferred to each manual outlet that corresponds to the amount transferred (Rs. 14 million.) were not provided for the audit verification. Hence, the accuracy and the completeness of the entry passed and the amount indicated therewith could not be examined nor relied.

(viii) The inventory valuation method followed by the management was not in consistent with the requirements of LKAS 2 “Inventories”. The financial impact arising therewith on cost of sales and current assets in the financial statements could not be determined or quantified.

(ix) It was identified a substantial quantity of stocks remaining in the warehouse, said to be stocks returned by the Company’s outlets island wide representing stocks returnable to the suppliers and stocks already has expired. However, the company has not quantified nor valued these stocks and has not been accounted at each year-end.

(d) Advances

The advances given amounting to Rs. 220,192,249 do not supported with documentary evidence. Owing to this, my verification scope was limited in ensuring the completeness, ownership and accuracy of the recoverable balances reported in the financial statements.

(e) Bank Reconciliations

Unidentified deposits amounting to Rs.10,735,872 have been stated as other income in the financial statements and there were significant amount of cheques issued but remained un-presented for more than six (06) months shown in the year end bank reconciliation statement of current account maintained with People's Bank Corporate Branch. The impact that will effect on the accounts, had these deposits been identified of its nature and purpose and reissued or adjusted for cancellation of the un-presented cheques respectively, could not be assessed nor quantified.

(f) Outlet Cash Control

The above account balance of outlet cash control shown under the account heading "cash in hand" in the financial statements amounting to Rs.314,126,445. However, the cash held by each outlet as at 31 December 2016 as per the breakup schedule provided amounts to Rs.192,958,901 reflecting an un-reconciled balance of Rs.121,167,544. It was unable to satisfy the accuracy, and the completeness of this balance since, access to source documents was denied.

(g) Significant value with Related Party Balances

The balance confirmed by M/S Sathosa Security and General (Pvt) Limited as payable to them by the Company as at 31 December 2016 differs by Rs.1,224,996. Similarly, the balance confirmation called from Corporative Wholesale Establishment (CWE) as at the same date, revealed that, the total balance confirmed by CWE under different classifications of accounts amounts to net of Rs.360,126,533 as receivable to them by the Company. Whereas, the balance payable to CWE by the Company as per the accounts also classified under different headings of accounts amounts to net of Rs.220,284,015 reflecting a difference of Rs.139,842,518 in dispute. As per the differences highlighted above, the accuracy and the completeness of such balances could not be relied.

(h) Projects under Investigations

I also draw attention to my observations included in the Special Audit Report on Rice Importation Process of Lanka Sathosa Ltd. in the years 2014 and 2015 which submitted in Parliament on 30 December 2016.

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the significance of the matters described in the paragraph of 1.4, 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 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 for disclaimer of opinion and scope and limitations of the audit are as stated above.

(b) In my opinion:

- I have not been able to obtain sufficient and appropriate audit evidence that were required for the audit as stated in paragraphs (a) to (h) of this report and, as far as appears from my examination, no adequate accounting records have been kept by the Company.

- The financial statements of the Company do not comply with the requirements of Section 151 of the Companies Act, No. 07 of 2007.

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

Contrary to the Public Enterprises Circular No. PED/1/2015 dated 25 May 2015 and on the approval of the Board of Directors, sums totalling Rs.1,647,917 had been paid as transport allownces during the year under review to 13 officers who were not entitled to use official vehicles.

2.4 Transactions not Supported by an Adequate Authority

Without being obtained the Treasury approval in terms of Section 9.7 of the public Enterprises Circular No.PED/12 dated 02 June 2003.professional Allowances totalling Rs.647,833 at Rs.10,000 per month had been paid to 08 officers who had submitted the professional qualifications and performance Allowance totalling Rs.1,312,500 at Rs.75,000 per month had been paid to three Deputy General Managers during the year under review on the approval of the Board of Directors.

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. 5,130,038,519 as compared with the corresponding deficit of Rs. 1,945,253,021 for the preceding year, thus indicating a increase of 164 per cent or Rs. 3,184,785,498 in the financial result of the year under review as compared with the preceding year. The increase in sales income by Rs.2,007,256,687 despite the increase of cost of sales by Rs. 6,259,210,197 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 2011 amounting to Rs. 251,490,199 had increased to Rs. 1,156,456,272 by the end of the year 2013 with fluctuation annually incurring losses of Rs.3,460,051,129, Rs.1,945,253,021 and Rs. 5,130,038,519 in the years 2014, 2015 and 2016 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 2011 up to the year 2013, but in the years 2014,2015 and 2016 the contribution had recorded the minus values of Rs. 1,922,368,825, Rs.42,040,870 and Rs. 3,066,064,651 respectively.

4. Operating Review

4.1 Performance

4.1.1 Planning

In terms of Section 5.1 of the Public Enterprises Circular No.PED/12 dated 02 June 2003, a Corporate Plan and a corresponding Action Plan should be prepared for a period not less than 03 years for the achievement of vision and mission of the Company. Nevertheless, only an Action Plan had been prepared for the year under review without being prepared the Corporate Plan. Further, in accordance with Section 5.2 of the Circular, an annual budget should be prepared so as to be complied with the Corporate Plan and the Action Plan. Nevertheless, an annual budget had not been prepared pertaining to the year under review.

4.2 Resources of the Company given to other Public Institutions

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Contrary to Section 9.4 of the Public Enterprises Circular No.PED/12 dated 02 June 2003, fourteen members of the staff of the Company had been attached to the Line Ministry without the approval of the Cabinet by the end of the year under review and a sum of Rs.2,032,692 had been paid as salaries and allowances of those officers during the year under review by the Company. A request had not been made to the Ministry to reimburse the above expenditure.

4.3 Management Activities

The following observations are made.

(a) Import Clearing Advance

Following observations are made on the advances paid to a clearing agency regarding the importation of rice held by the Company in the years of 2014 & 2015.

(i) None of the Procurement Guidelines had been followed when selecting the clearing agency.

(ii) Out of the advance amounting Rs.1,224,541,593 paid in 53 instances in the year 2015 a sum of Rs. 242,600,501 and advance amounting to Rs.25,000,000 paid in 03 instances during the year under review had not been settled even by 31 March 2019, the date of audit and the settlement was no longer delayed due to inadequacies' with the clearing agency.

(iii) In response to the audit query, made in relation to interdictory information of advance payments submitted by the company had not been made by 31 March 2019.

(b) Due to the internal control weaknesses found in the outlets with regard to the stocks, it had not been possible to compute stock losses accurately. As such, out of the loss of Rs.13,660,217 identified for claiming insurance indemnity in connection with burgling 23 outlets of the Company during the year under review, sums totalling Rs.2,758,666 only had been received as the relevant insurance indemnity. Further, action had not been taken to identify the parties that should be held responsible for the relevant losses and recover the same.

4.4 Uneconomic Transactions

At the discussions held between Minister in Charge of the Line Ministry and the officers of the institutions functioning under the Ministry, a decision had been reached to purchase brown sugar stocks from the Lanka Sugar Company Ltd. by the Co-operative Wholesale Establishment and sale such stocks to the other Public institutions and private institutions. Accordingly, the Chairman of the Co-operative Wholesale Establishment (CWE) had sought the concurrence of the Chairman of the Lanka Sathosa Ltd. to supply stocks of brown sugar on 08 January 2016 and the Chairman of the Lanka Sathosa Ltd. had informed on 13 January 2016 that there were sufficient stocks with the company and therefore, it was not possible to purchase sugar from the CWE and priority would be given to purchase sugar from the CWE once the stocks of sugar become exhausted. Nevertheless, Lanka Sathosa Ltd. had taken action to purchase 200,000 kilograms of brown sugar on 13 January 2016 at Rs.93.65 per kilogram by calling for tenders on 12 January 2016. It was observed according to the information obtained in audit that the CWE had sold the above brown sugar at Rs.80.50 per kilogram. Therefore, due to taking action to purchase 200,000 kilograms of brown sugar at Rs.93.65 per kilogram from an external institution that could have been purchased at Rs.80.50 per kilogram from the CWE, the Company had to incur an additional expenditure of Rs.2,630,000.

4.5 Staff Administration

The approved cadre of the Company was 3075 and the actual cadre was 3641. The following matters were observed in that respect.

(a) In parallel to the increase in the number of outlets of the Company, an additional staff of 787 members had been recruited by the end of the year under review, whereas approval had not been obtained thereon and recruitments to 221 posts of the approved cadre had not been made.

(b) Four officers who were recruited as the management experts to the Line Ministry had been attached to the Company and a sum of Rs.1,410,000 had been paid as the allowances of those officers during the year under review.

(c) An Accountant who was interdicted in the year 2015 had been reinstated as the Manager (Operations) on 29 February 2016 following a disciplinary inquiry. Nevertheless, it was not established in audit that the above officer had satisfied the qualifications applicable to the aforesaid post.

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 60 days from the close of the financial year. Nevertheless, financial statements for the year 2016 had been furnished on 25 October 2018.

5.2 Procurement and Contract Process

5.2.1 Procurement

The following observations are made.

(a) The Project of Installation of CCTV Camera System

The contract which is entered with a supplier relevant provides CCTV camera system on 10 June 2016, and the value of the project is Rs. 142,292,252. The following observations are made in this regard.

(i) Although the supplier who had been entrusted with the above project had obtained the contract on equipment and capability of another principal company, the agreement with the main company had expired on 17 December 2017. Therefore, there was uncertainty about the acquisition of principal company equipment and capacity capabilities.

(ii) The following non-compliances with Procurement guidelines were observed.

- In Accordance with guideline 2.7.4, the Ministry Procurement Committee consisted of an officer of the ministry & head of the entity, but the remaining member was not a member in the relevant field and the member was a member of Board of Directors.
- The specializations of the bidding documents have been changed without the approval of the Technical Evaluation Committee in accordance with the guidelines 2.6.

- The evidence was not presented for the audit to prove that the supplier who was contracted in accordance with 5.3.5 was a documented supplier registered in the Construction Industry Development Authority.

(III) There are Technical Evaluation Committee noted that there are 54 items in out of 55 items included in the technical specifications, no attention has been paid in the bid evaluation.

(IV) A mobilization advance amounting to Rs. 27,654,280 had been paid without obtaining a bank guarantee.

(b) Installation of Enterprise Resource Planning System (ERP System)

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(i) The company had been entered in to an agreement with a supplier for installation of ERP System amounting to Rs. 198,175,784 and The following non-compliances with Procurement guidelines were observed in this regard.

- In Accordance with guideline 2.7.4, the Ministry Procurement Committee consisted of an officer of the Ministry & head of the entity, but the remaining member was not a member of the relevant field and the member was a member of Board of Directors.
- According to the Procurement guidelines 2.3.2, specifications and bid documents related to the project had not been obtained and submitted to the Technical Evaluation Committee.
- Required recommendations of all members of the TEC consisting of five members according to the Procurement guidelines 2.8.3., only three members had been given recommendations..

(II) A mobilization advance amounting to Rs 39,635,157 had been paid without obtaining a bank guarantee.

(c) The buildings obtained on rent basis from various areas of the island by the Company for the maintenance of sales activities, had been secured while deviating from the procurement process and rent totalling Rs.415,816,042 had been paid thereon during the year under review.

(d) In respect of supplying hired vehicles, a sum of Rs.5,506,927 had been paid to a hired vehicles supplying institution selected deviating from the procurement process.

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
(a)	Control of Procurement Activities	Guidelines in the Government Procurement Guidelines had not been adopted in the procurement activities.
(b)	Human Resources Management	Absence of an approved scheme of recruitment and making irregular recruitments and promotions.
(c)	Budgetary Control	An annual budget had not been prepared and therefore, it had not been possible to make use of the same as an effective instrument of management control.
(d)	Inventory Control	(I) Action had not been taken to maintain correct inventory records. (II) Absence of proper methodology for the valuation of inventory. (III) physical stock counting is not done in property.
(e)	Accounting Systems	(i) Management Information System for accounting is insufficient and inadequate. (ii) Lack of proper evidence and approval for accounting adjustments.
(f)	Control of Assets	(i) Lack of fixed assets register. (ii) Absence of a proper methodology for capitalization of assets.