

## **Cey-Nor Foundation Limited -2016**

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The audit of financial statements of the Cey-Nor Foundation Limited for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the 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 regarding the performance of the year under review which I consider should be presented to 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**

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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 management 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**

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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 misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Foundation'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 Foundation'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 Basis for Qualified Opinion

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### (a) Sri Lanka Accounting Standards

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The following non-compliances were observed.

#### (i) Sri Lanka Accounting Standard 1

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Even though a description of the nature and purpose of each reserve within equity should be disclosed in terms of paragraph 79(b) of the Standard, it had not been so done.

- ❖ In terms of paragraph 117 of the Standard, the significant accounting policies should be disclosed for understanding of the financial statements. Nevertheless, the accounting policy relating to financial instruments had not been disclosed.

#### (ii) Sri Lanka Accounting Standard 12

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In terms of paragraphs 79, 80 and 81 of the Standard, disclosures relating to tax expenses of the year under review had not been made.

#### (iii) Sri Lanka Accounting Standard 16

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Even though the entity had identified a revaluation reserve of Rs.260,559,448 in the financial statements, in terms of paragraph 77 of the Standard, the following disclosures had not been disclosed in the financial statements.

- The effective date of the revaluation;
- Whether an independent valuer was involved;
- Methods and significant assumptions used in estimating fair values of assets.

#### (iv) Sri Lanka Accounting Standard 19

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In terms of paragraph 57 of the Standard, the defined benefit liability should make a reliable estimate through the projected unit credit method. However, contrary to the Accounting Standard, the entity had computed it multiplying half of the salary obtained at the end of the month of the previous financial year by the number of years completed by each officer.

#### (v) Sri Lanka Accounting Standard 24

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In terms of paragraph 17 of the Standard, the key management personnel benefits had not been disclosed by the entity.

#### (vi) Sri Lanka Financial Reporting Standard 07

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The following observations are made.

In terms of paragraph 08 of the Standard, the carrying amount of financial assets and financial liabilities should be disclosed either in the statement of financial position or in the notes. Nevertheless, it had not been so disclosed.

In terms of paragraphs 31 and 33 of the Standard, information required to evaluate the nature and extent of risks arising from financial instruments, exposed at the end of the reporting period, had not been disclosed.

(b) **Accounting Policies**

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In terms of paragraph 08 of the Sri Lanka Accounting Standard 23, the borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as a part of the cost of that asset and the other borrowing costs should be recognized as an expense in the said period. However, contrary to it, an accounting policy had been identified by the Foundation that the borrowing costs are recognized as an expense of the entity.

(c) **Accounting Deficiencies**

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The following observations are made.

- (i) The Sri Bangalas Boats Manufacturing Company, which was commenced according to an agreement entered into with an investor of Bangladesh by the Cey-Nor Foundation Limited on 14 February 2008, was running at a loss and as such, the agreement had been terminated on the decision dated 28 July 2016 of the Board of Directors. However, according to Sri Lanka Accounting Standard 36, allocations had not been made for impairment of investment of Rs.1,961,850 remained as at 31 December 2016.
- (ii) Depreciation of Rs.166,695 and Rs.1,867,241 for fully depreciated Tractor Trailers and Motor Cars respectively had been further brought to account in the year under review and as such, the net value of assets and the profit had been understated by Rs.2,033,936 as at the end of the year under review.
- (iii) Even though the debtors balance amounting to Rs.125,303,319 remained as at 31 December 2016, comprised of debtors balance totalling Rs.22,203,074 remained unrecovered from the years 2004, 2011 and 2015, only allocations of Rs.6,392,490 had been made for bad and doubtful debts and it was observed in audit that those allocations were inadequate.

**(d) Unexplained Differences**  
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The following observations are made.

- (i) According to the financial statements of the Cey-Nor Foundation, sums of Rs.26,294,662 and Rs.18,294,909 had been shown as receivable and payable from and to the Northsea (Pvt) Ltd. respectively according to the financial statements of the Cey-Nor Foundation as at 31 December 2016, whilst according to the financial statements of the Northsea (Pvt) Ltd., those balances had been Rs.24,978,402 and Rs.24,846,086, thus indicating unexplained differences of Rs.1,316,260 and Rs.6,551,177 respectively.
- (ii) Even though the value of fixed assets according to the statement of financial position had been Rs.20,505,436, according to the Register of Fixed Assets, that value had been Rs.29,774,369, thus indicating a net difference of Rs.9,269,203.
- (iii) According to the financial statements, the turn-over of the year under review had been Rs.205,502,518. Nevertheless, in the comparison of the turn-over used in the computation of Nation Building Tax with the turn-over used for payment of Value Added Tax, differences of Rs.1,070,507 and Rs.3,069,618 were observed respectively.

**(e) Lack of Evidence for Audit**  
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The following observations are made.

- (a) Confirmation of balances for debit balance of Value Added Tax amounting to Rs.11,719,949 out of the Value Added Tax of Rs.1,458,292 shown under balances payable in the financial statements, debit balance of Economic Service Charges amounting to Rs.138,205 and for Economic Service Charges of Rs.2,466,894 paid in advance, included in other receivable balances, had not been made available.
- (b) The Cabinet Paper dated 02 November 2010 in respect of vesting of two Factories at Lunuwila and Weerawila belonging to the Cey-Nor Foundation in the Northsea (Pvt) Ltd., report on the computation of vested value of assets or the valuation report of the Government Valuer, had not been made available to Audit.

## **2. Financial Statements**

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### **2.1 Qualified Opinion**

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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 Cey-Nor Foundation Limited as at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### **2.2 Report on other Legal and Regulatory Requirements**

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

- (a) The basis of qualified opinion and scope and limitations of the audit are 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 appears from my examination, proper accounting records have been kept by the Foundation.
  
  - ❖ The financial statements of the Company comply with the requirements of Section 151 of the Companies Act, No.07 of 2007.

### **2.3 Accounts Receivable and Payable**

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The following observations are made.

- (a) Action had not been taken even in the year under review to settle 05 other receivable balances totalling Rs.9,202,662 brought forward from many years.
- (b) Action had not been taken to identify and settle the sales advances of Rs.113,123,958 included in the other payable balance of Rs.138,912,830 remained as at 31 December 2016.
- (c) A negative balance of Rs.230,012 in favour of the Sri Lanka Cricket Board included in the debtors balance indicated in the financial statement, over a period of 03 months and action had not been taken to settle that balance.
- (d) Action had not been taken to settle advances of Rs.6,477,608 older than a period of one year as at 31 December 2016.

### **3. Financial Review**

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#### **3.1 Financial Results**

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According to the financial statements presented, the financial result of the Foundation for the year under review had been a net profit of Rs.9,264,551 as compared with the corresponding net profit of Rs.61,814,529 for the preceding year, thus indicating a decline of Rs.52,549,978 in the financial result of the year under review as compared with the preceding year. The increase in the sales cost by Rs.54,192,681 had been the main reason for the said decline.

### **4. Operating Review**

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#### **4.1 Performance**

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In terms of the Memorandum of Association, the main objectives of the Cey-Nor Foundation which is governed by the Companies Act, No.07 of 2007, were as follows.

- (a) To carry on the business of building, manufacturing, sales and operating workshops for repair and reconditioning of trawlers, fishing vessels, marine motors and other marine equipment.
- (b) To undertake the business of manufacture of ice and marine products and the processing, packaging, marketing and export of these products.
- (c) To carry on the business of the manufacture and sell of fishing nets and allied fishing gears in Sri Lanka or abroad.
- (d) To act as a commission agent, sales agent or manufacturer with regards to the activities of the Foundation.

The following observations are made in the achievement of the above mentioned objectives.

- (i) Even though the manufacturing of ice and performing allied activities and manufacturing of fishing nets indicated under main objectives of the Foundation had been withdrawn from the said objectives at present, action had not been taken by the Foundation to amend the Memorandum of Association accordingly.
- (ii) Even though it had been planned by the Corporate Plan of the year 2016 to establish 300 retail shops for expanding the function of the Foundation as a trade agent, that function had not been performed and it was observed that operating activities of all retail shops had been discontinued by November 2017.

## 4.2 Management Activities

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The following observations are made.

- (a) The following observations were made in respect of leasing out the motor vehicle repair workshop located at Mattumagala, belonging to the Cey-Nor Foundation Limited to a private company for a period of 15 years from 02 August 2016.
  - (i) According to the said lease agreement, 3 per cent of annual turnover is required to be paid to the Foundation by the lessee, subject to minimum rentals of Rs.100,000 in first 05 years, Rs.150,000 in second 5 years and Rs.250,000 in third 5 years. A fee amounting to Rs.1,800,000 at a rate of Rs.150,000 per month had been recovered for the first year and the Foundation had not examined the audited financial statements of the lessee company for the confirmation of accuracy of the income so recovered.
  - (ii) Title deeds or any evidence whatsoever required for the confirmation of legal ownership of the land on which the motor vehicle repair workshop is located at Mattumagala, had not been made available to Audit.
  - (iii) In terms of Clause 2(d) and (c) of the said lease agreement, it had been cited that the employees who were deployed in the service of that workshop are absorbed to the lessee company at the instance of leasing out and the salaries paid to those employees should be reimbursed by the said company to the Cey-Nor Foundation. However, according to Board of Directors Paper dated 22 July 2016, it was revealed that those employees had not been absorbed into the company.
  - (iv) Even though the lessee company had changed its business name, action had not been taken to revise the lease agreement accordingly.
- (b) The land of 2 roods 18.24 perches in extent located at D.R.Wijewardana Mawatha, Colombo 10, belonging to the Foundation had been leased out to a private company (Cey-Nor Orient Sea Food Restaurant) on 04 July 1998 at a rate of Rs.40,000 per month for 20 years and the following matters were observed in that connection.
  - (i) In addition to the said lease amount, a share of 40 per cent of the net profit of the said Business should be paid to the Cey-Nor Foundation without charging depreciation in respect of the buildings in terms of the lease agreement. However, that portion had not been received from the year 1998 to the year 2011 and the Cey-Nor Foundation had not even examined the audited accounts of the relevant company.
  - (ii) In case, the net profit earned from the said business is not reasonably adequate during any consequent period of 5 years, the lessor has the right to terminate this lease agreement without the consent of the lessee in terms of Clause 11 of the agreement. Nevertheless, action had not been taken to terminate the agreement on non-receipt of share of profit receivable according to the agreement.

- (iii) In terms of Clause 12 of the Agreement, it had been agreed to pay a sum of Rs.250,000 by the lessor to the lessee per each year or part thereof of the remaining period after termination of the agreement. Further, at the instance of entering into the agreement, the Management had neglected that disadvantageous Clause made contrary to the terms of the Clause 11.
- (iv) The period of the said lease agreement had terminated on 04 July 2018 and the Board of Directors of the Foundation had decided to lease out again to the present lessee for a period of 30 years from that date under the approval of the Department of Public Enterprises, Cabinet of Ministers and Attorney General's Department. Accordingly, the value of annual assessed lease rental obtained from the Valuation Department on 20 September 2016 had been Rs.39,300,000 and the present lessee did not agree to obtain the said land for that value. As such, the value of lease rental of the land for a period of 30 years had been reassessed as Rs.604,000,000 on 29 November 2016. According to the assessed value obtained at the second time, the annual lease rental of the land had been Rs.20,133,333 and reasons for decrease in the second assessed value by Rs.19,166,667 than the first value had not been explained to Audit.

#### **4.3 Operating Activities**

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The following observations are made.

- (a) Two mobile workshops and 105 unvalued tools and other items of equipment belonging to the Cey-Nor Foundation Limited had been leased out to a private company on 17 August 2006. The following observations are made in that connection.
  - (i) In terms of Clause 6(c) of the lease agreement, an insurance coverage to the value of Rs.2.5 million should be obtained by the lessee for losses sustained in every mobile workshop. Nevertheless, action had not been taken to obtain such insurance coverage and attention of the Management as well had been paid thereon.
  - (ii) In the vesting of workshops to the lessee company, 105 units of tools and other equipment had been handed over. However, a physical verification had not been carried out in that connection.

#### **4.4 Transactions of Contentious Nature**

##### **(a) Investment in Sri Bangalash Boat Manufacturing Company**

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According to the Cabinet Decision No. අමෙ/07/0198/351/001 dated 22 February 2007, the Cey-Nor Foundation Limited had entered into an agreement on 18 February 2008 with the Elite Agro Industries (Pvt) Ltd. in Bangladesh to commence a joint venture for the purpose of manufacturing of fishing boats. The following observations are made in this connection.



- (i) Even though a bank security in respect of the joint partner of the venture should be obtained in terms of the Agreement, action had not been so taken.
- (ii) Even though the investment of the Foundation had been US\$.80,000 according to the agreement, the Foundation had invested a sum of US\$ 101,265 and as such, a sum of US\$ 21,265 had been overinvested. However, no benefits whatsoever from the investment had been received to the Cey-Nor Foundation up to the year 2017.
- (iii) Even though the approval had been granted by the Board of Directors Paper No.310 dated 28 July 2016 to complete the project, action had not been taken to terminate the project even by the date of this report and a value of Rs.1,961,850 had been indicated in this connection under investments in the statement of financial position of the year under review.

**(b) Vesting of Fishnet Factories in a Public Company**  
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According to the Cabinet Decision No. අම/10/2658/418/015 dated 18 November 2010, two Fishnet Factories at Lunuwila and Weerawila, belonging to the Cey-Nor Foundation Limited had been vested in the Northsea (Pvt) Ltd. The following observations are made in that connection.

- (i) Before making recommendations to the Cabinet of Ministers on vesting and taking over of Factories, a market survey **on a scientific basis**, an evaluation of investments or a feasibility study had not been carried out thereon by the Ministry of Finance and Planning.
- (ii) The Cey-Nor Foundation Limited, being the sole agent with the International Standard Certification (ISO 9001,2000) for the manufacture of Nylon fishnets in Sri Lanka, had manufactured 148,186 kg of fishnets through these two Factories and an income of Rs.215.6 million had been earned from the sale of fishnets. It was 64 per cent of the entire income of the Foundation and orders for supply of 66,560.69 kg of fishnets had been undertaken by the Foundation by the instance of vesting of those Factories. Despite the fact, it was observed in audit that the vesting of those two Factories in another institution has adversely affected the Fisheries Sector and the Foundation.
- (iii) Even though the Foundation had handed over the raw materials valued at Rs.14,676,642 to the Northsea Limited by the instance of vesting of those two Factories with the Northsea Limited, the value of stocks of these raw materials had not been taken into account the purchase consideration at the time of vesting of those stocks.
- (iv) According to the financial statements of the year 2011, a sum of Rs.37,488,524 had been deducted as the revaluation loss in the vesting of fixed assets with the book value of Rs.51,688,575 and leased assets with the book value of Rs.18,137,565, belonging to the Cey-Nor Foundation Limited. According to the report referred to the Secretary to the Ministry on 11 March

2011 by the Chairman, it had been indicated that the market value of assets vested, had been Rs.77,800,000. According to the audited financial statements of the year 2011, the market value of assets with the net book value of Rs.69,826,140 had been indicated as Rs.77,800,000 and as such, the identification of a revaluation loss of Rs.37,488,524 was questionable in audit. However, assets belonging to the Foundation had not been properly valued and vested.

#### **4.5 Uneconomic Transactions**

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##### **(a) Hiring out the Excavator owned by the Foundation**

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The following observations are made.

- (i) A contract agreement had been entered into for hiring out the excavator owned by the Foundation to the Fishery Harbours Corporation on the basis of payment of a sum of Rs.11,000 per hour of a working day and at a minimum sum of Rs.44,000 per day for a period of 06 months from 10 September 2016 to 11 March 2017. However, the Foundation had not taken action to recover any money whatsoever recoverable from that Corporation.
- (ii) This machine had been hired out on lease basis by the Fishery Harbours Corporation to an external institution from 08 November 2016 and it had been agreed to pay a sum of Rs.3,500 per working hour, Rs.50,000 per month for lubricant oil and maintenance activities and Rs.500,000 as security deposits to the Corporation. Nevertheless, according to the agreement entered into with the Cey-Nor Foundation by the Fishery Harbours Corporation, provisions had not been made for sub-letting.
- (iii) This machine, purchased at a cost of Rs.40 million on 27 October 2014, had been sold for Rs.28 million to the Fishery Harbours Corporation without assessing the value within a period not exceeding even three years.

#### **4.6 Identified Losses**

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An Ambulance Boat had been manufactured by the Cey-Nor Foundation by spending a sum of Rs.4,515,923 without entering into a written agreement on an order placed by the Northern Provincial Ministry of Health Services in the year 2015. A boat engine valued at Rs.1,130,000 had been purchased and fixed to the said boat without confirming by a Technical Evaluation Committee that it is in compliance with specified specifications and the purchaser had rejected the purchase of the said boat due to overheat of the engine. As such, a total sum of Rs.4,515,923 spent for the boat and the engine had become a loss to the Foundation.

#### **4.7 Staff Administration**

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The following observations are made.

- (a) The approved cadre as at 31 December 2016 stood at 135 whilst the actual cadre stood at 86 and as such, 50 vacancies and 01 excess cadre existed.
- (b) Action had not been taken even up to the date of the report to fill the posts of the Assistant Manager (Operations) and the Human Resources Manager, vacant from 26 April 2012 to 01 December 2016.
- (c) Even though the post of Workshop Manager existed in the approved cadre, a workshop was unavailable in the Foundation, as the Workshop at Mattumagala owned by the company, had been leased out to another institution. As such, that officer had been assigned the duties the Transport Manager, despite the unavailability of a post of Transport Manager in the approved cadre.

#### **5. Accountability and Good Governance**

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##### **5.1 Presentation of Financial Statements**

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In terms of Section 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the draft Annual Report and the financial statements should be presented to the Auditor General within 60 days after closure of the financial year. Nevertheless, the financial statements for the year under review had been presented to Audit on 08 September 2017 after a delay of 06 months.

##### **5.2 Corporate Plan**

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The following observations are made.

- (a) Action had not been taken to review and update the Corporate Plan timely, prepared by the Foundation relating to the period from 2013 to 2017.
- (b) Even though a sum of Rs.87 million had been planned to be earned from manufacture of engine spare parts and fishing gear and from repair of boats in the year under review, no such activities whatsoever had been carried out.

##### **5.3 Action Plan**

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The following observations are made.

- (a) The Action Plan of the Foundation had not been prepared in compliance with the objectives of the Corporate Plan.
- (b) In terms of the Public Enterprises Circular No.PED/12 of 02 June 2003, a copy of the Action Plan approved for the ensuing year should be presented to the Auditor General by the Board of Directors, 15 days before the commencement of the financial year. Nevertheless, the Action Plan for the year 2016 had been presented to Audit by the Board of Directors only on 19 October 2016.

#### **5.4 Internal Audit**

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The following observations are made.

- (a) An adequate staff had not been approved for the Internal Audit Unit and that Unit consisted only of the Divisional Head and another officer, thus resulting in a hindrance to achieve the expected performance of the Internal Audit Unit and main objectives of the establishment of that Unit.
- (b) In terms of the Management Audit Circular No.DMA/2009 (I) dated 09 June 2009, the Internal Audit Programme approved for the year under review had not been presented to the Auditor General.
- (c) Even though action should be taken in terms of Financial Regulation 134 to submit the internal audit reports to the Auditor General, the internal audit reports for the year 2016 had not been presented to Audit even by the date of this report.

#### **5.5 Procurement Process**

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In terms of Guideline 4.3.1(a) of the Procurement Guidelines, a total cost estimate should be prepared for every purchase. However, a cost estimate had not been prepared in the purchase of raw materials valued at Rs.8,256,101 and C.C.T.V. cameras valued at Rs.1,376,413 in the year under review. Moreover, a proper contract agreement as well had not been entered into in terms of Guideline 8.9.1(b) of the Procurement Guidelines.

#### **5.6 Budgetary Control**

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The following observations are made.

- (a) In terms of Section 5.2.4 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the draft budget of an institution should be placed before the Board of Directors for approval, 03 months before the commencement of the financial year. However, the budget of the Cey-Nor Foundation for the year 2016 had been approved at the 315<sup>th</sup> meeting of the Board of Directors held on 27 December 2016.
- (b) In terms of Section 5.2.5 of the said Circular, copies of the annual budget approved by the Board, should be forwarded to the line Ministry, the Department of Public Enterprises, General Treasury and the Auditor General not later than 15 days before the commencement of the financial year. However, action had not been taken accordingly.
- (c) In terms of Section 5.2.1 of the said Circular, the annual budget should be prepared in accordance with the format in which the Annual Accounts are presented. However, statement of budgeted financial position and the statement including budgeted capital expenditure had not been included in the annual budget presented by the Foundation.

## 6. Systems and Controls

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

<b>Areas of Systems and Controls</b>	<b>Observations</b>
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(a) Procurement Process	Non-compliance with certain Procurement Guidelines.
(b) Operating Control	Failure in taking action for proper recovery lease rental income.
(c) Action Plan	Failure in taking action to achieve the objectives mentioned in the Action Plan.
(d) Operating Activities	Failure in carrying out operating activities properly.
(e) Management Activities	In entering into lease agreements, concurrence with sections which are not beneficial to the Foundation.