

## **Ceylon Fertilizer Company Limited - 2016/2017**

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The audit of financial statements of the Ceylon Fertilizer Company Limited for the year ended 31 March 2017 comprising the statement of financial position as at 31 March 2017 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 on the performance of the Company in 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 Management's Responsibility for the Financial Statements**

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The management 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 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 of the Company**

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The Ceylon Fertilizer Company Limited has been incorporated under the State Industrial Corporations Act, No. 49 of 1957 with the financial and technical assistance of the Federal Republic of Germany in the year 1964. It had been re-established as Ceylon Fertilizer Company Limited with effect from 15 September 1992 in terms of the Conversion of Public

Corporations or Government Owned Business Undertakings into Public Companies Act, No. 23 of 1987 and it has been registered and operated under the Companies Act, No.07 of 2007 at present.

## **1.5 Basis for Qualified Opinion**

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My opinion is qualified based on the matters described in paragraph 2.2 of this report.

## **2. Financial Statements**

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### **2.1 Qualified Opinion**

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In my opinion, because of the significance of the matters described in paragraph 2.3 of this report, the financial statements give a true and fair view of the financial position of the Ceylon Fertilizer Company Limited as at 31 March 2017 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 opinion and scope and limitations of the audit are stated as follows.
- (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 Company.
  - The financial statements of the Company comply with the requirements of Section 151 of the Companies Act, No.07 of 2007.

### **2.3 Comments on Financial Statements**

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#### **2.3.1 Sri Lanka Accounting Standards**

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The instances of non-compliance with Sri Lanka Accounting Standards are given below.

##### **(a) Sri Lanka Accounting Standard 19**

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Even though an entity shall separately recognize the net defined benefit liabilities and assets in the statement of financial position in terms of Paragraph 63 of the Standard, it had not been so done.

**(b) Sri Lanka Accounting Standard 39**  
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- (i) In terms of Paragraph 08 of the Standard, the financial assets held-to-maturity with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity should be classified as financial assets held to maturity. Nevertheless, assets valued at Rs.3,844,988,912 had been classified as other financial assets in the financial statements.
  
- (ii) Even though held-to-maturity investments amounting to Rs. 532,548,539 should be measured at amortized cost using the effective interest method in terms of Paragraph 46(b) of the Standard, action had not been taken accordingly.

**2.3.2 Accounting Deficiencies**  
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The following observations are made.

- (a) The interest income on fixed deposits and Treasury bills as at 31 March 2017 had been understated by Rs.12,632,701 and as such, the income tax payable had been understated by Rs.3,537,156.
  
- (b) Taxes amounting to approximately Rs.130,724 had been under-assessed as the bungalow charges, rental income, income from transportation and sales of fertilizer bags totalling Rs.7,498,445 included in the operating income shown in the financial statements had not been considered in the computation of Nation Building Tax.

**2.3.3 Unexplained Differences**  
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Even though the turnover on redemption from Nation Building Tax of the Company for the year under review amounted to Rs.253,056,860 , it was shown as Rs. 249,439,632 in the Report on Nation Building Tax, thus indicating a difference of Rs.3,617,228.

**2.4 Accounts Receivable and Payable**  
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A sum of Rs.87,474,958 recoverable from 4 institutions to the Company pertaining to a period ranging from 10 to 20 years had not been recovered in the year under review as well.

**2.5 Non-compliance with Laws, Rules, Regulations and Management Decisions**  
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The following instances of non-compliance were observed.

<b>Reference to Laws, Rules and Regulations</b>	<b>Non-compliance</b>
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(a) Companies Act, No. 07 of 2007 ----- (i) Section 131(1)	Annual returns of the years 2014/2015 had not been delivered to the Registrar of the Company even by 30 September 2017.
(ii) Section 223	The changes in the Board of Directors made after 05 May 2015 had not been notified to the Registrar of the Company even by 15 September 2017.
(b) Government Procurement Guidelines -2006 ----- Sections 2.8.1, 2.8.5, 4.3.1, 4.3.2, 5.4.8, 7.9.2	A detailed estimate for the evaluation of bids in respect of the contract valued at Rs.1,992,175 for the repairing of roof of the Stores No.4, had not been submitted while no agreement had been entered into with the contractor as well. Further, a performance security therefor had also not been obtained.
(c) Public Finance Circular No. PF/PE/21 of 24 May 2002	A draft annual report had not been submitted along with the financial statements of the year under review.

### **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 Company for the year under review had been a surplus of Rs.139,592,032 as compared with the corresponding surplus of Rs.603,272,829 for the preceding year thus indicating a deterioration of Rs.463,680,797 in the financial result of the year under review as compared with the preceding year. Even though the financial income had increased by Rs.164,008,366, the decrease in the administration expenditure and gross profit by Rs.94,368,978 and Rs.866,422,146 respectively had been the main reasons for the said deterioration.

In the analysis of the financial results of the year under review and 04 preceding years, it was observed that the net profit of Rs.126,856,580 for the year 2012/2013 had increased up to Rs.603,272,829 continuously by the end of the year 2015/2016. Nevertheless, after the discontinuation of fertilizer subsidy programme, the net profit of the year under review had decreased to Rs.139,592,032. After readjusting the employees' remuneration, depreciation for property, plant and equipment and Government tax to the financial result, the contribution

of the Company amounting to Rs.428,414,541 in the year 2012/2013 had improved up to Rs.476,433,758 continuously by the year 2016/2017.

#### **4. Operating Review**

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##### **4.1 Performance**

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The Ceylon Fertilizer Company Limited had been established under the mission of ensuring the profitable sustainability of the company by manufacturing and distributing fertilizer catering to the multitude of market demands in order to increase products, income and profitability in the Sri Lanka agricultural and Farmer Community services in compliance with State policies.

As the paddy cultivation is a main crop in the Agriculture Sector in Sri Lanka, opportunity had been provided to farmers for the purchase of a fertilizer bag at a concessionary rate of Rs.350 from the year 2006 to 28 February 2016 as a State policy. Sixty five per cent of the requirement of fertilizer in respect of that subsidy programme had been fulfilled by the Ceylon Fertilizer Company Limited.

Even though an income of Rs.12.197 billion was targeted from the direct fertilizers such as Urea, MOP and TSP and mixed fertilizers, the actual sales income had been Rs.2.371 billion due to the discontinuation of fertilizer subsidy programme from 01 March 2016. As such, the sales income earned had been at a minimum level representing 19.44 per cent.

##### **4.2 Idle and Underutilized Assets**

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A fully equipped laboratory of 3000 square feet in extent with laboratory and other equipment valued at Rs.17,617,653 had been constructed with a view to carrying out sample tests of fertilizer under the provisions of Ministry of Agriculture and 04 laboratory assistants and a sample collector had been employed under a laboratory manager.

Nevertheless, quality tests for samples of fertilizer which are being carried out by the Fertilizer Secretariat had not been carried out by this laboratory and as such, those assets had remained underutilized.

##### **4.3 Legal Action initiated against the Company or by the Company**

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A case had been filed against four sales representatives claiming a compensation of Rs.268,335,298 pertaining to shortages of fertilizer stocks suffered by the Ceylon Fertilizer Company Limited from the year 2005 to the year 2007.

##### **4.4 Management Activities**

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Only a case had been filed as at 05 December 2017 to recover the loss of Rs.15,269,218 sustained by the company as a result of the shortage of fertilizer stocks of 281metric tons for which the former Stocks Officer in the regional fertilizer stores at Pottuvil in the year 2015 was responsible.

#### **4.5 Uneconomic Transactions**

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A sum of Rs.15,409,813 had been spent by the Company on the sponsorship for advertising and sales promotion and community services during the year under review. The following observations are made in this connection.

- (a) A sum of Rs.2,749,129 had been spent exceeding the expenditure limit of Rs.5,000,000 approved by the Board of Directors for the meeting of Sales Representatives and the programme of launching the organic fertilizer production held at the Grandia Hotel at Kurana in Negombo on 29 July 2016.

Even though quotations had been invited from three institutions for the organizing purposes of the programme as per the Government Procurement Guidelines, it was confirmed in audit that the said three institutions were the affiliated institutions under one institution. Further, a sum of Rs.3,232,500 or 43 per cent of the expenditure incurred for the organizing purposes of the function had been spent on the instructions of the Chairman and the Working Director.

- (b) Sums totalling Rs.2,813,140 had been spent for dramas, concerts, processions, schools for 97 New Year Festivals(Bakmaha Ulela) in Anuradhapura and Polonnaruwa districts, Rs.513,505 for 11 get-togethers, Rs.390,000 for lighting and floating 2000 candles in Kala Wewa at the inauguration day of the All island Agriculture Week and a sum of Rs.480,000 for birthday greeting cards had been spent contrary to the objectives of the Company.

#### **4.6 Matters of Contentious Nature**

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The following observations are made on the decision to pay a sum of Rs.35,848,212 as outstanding transport charges in respect of the transportation of 365,359 metric tons of fertilizer imported by the Company from January 2015 to February 2016 to the stores within 10 kilometers from the Port of Colombo.

- (i) An agreement for the payment of Rs.735 for the transportation of one metric ton had been entered into with the institution selected for obtaining transport services from 01 January 2014 to 31 December 2014 and subsequently the agreement period had been extended to 31 December 2016. However, the payments had been made at Rs.629.16 for the transportation of one metric ton during the period from 25 March 2015 to 29 April 2016 on the approval dated 30 April 2015 of the Board of Directors on the basis of decreasing prices of diesel on 22 January 2015.
- (ii) The relevant transport company had not raised any objection to the payment under the decreased price up to 23 February 2016 and for the first time a letter had been forwarded on 24 February 2016 stating that they were not agreed with the price decrease and claiming an outstanding amount of Rs.35,848,212.
- (iii) The said transport company had submitted a price of Rs.635 for the transportation of one metric ton of fertilizer pertaining to the bid opened on 16 June 2015, thus it was observed in audit that the decision to pay the outstanding amount had been baseless.

#### 4.7 Procurement and Contract Process

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The following observations are made.

- (a) An agreement had been entered into with a contractor for tarring roads of the premises of the Head Office of the Company and a mobilization advance of Rs.8,859,708 had been paid on a bank bond in February 2014. Subsequently, the construction work of contract had been abandoned on 11 May 2014 and as such, the value of performance bond amounting to Rs.2,214,927 had been recovered. Nevertheless, a court case for the recovery of advances totalling Rs.6,644,781 paid had been pending in an Arbitration Court even by 30 October 2017, the date of audit.
- (b) The following observations are made on the contract carried out by the Company for construction of a Circuit Bungalow at Buluela in Nuwaraeliya at a cost of Rs.27,188,304.
- (i) The ownership of the land had not been verified before the construction of the Circuit Bungalow.
- (ii) A private firm had been selected for obtaining consultancy services in respect of the said contract, deviating from the procurement procedure. In the preparation of Bill of Quantities pertaining to the constructions, standard price rates had not been used, thus a variance of Rs.576,728 in the estimated amount of the entire contract was observed.
- (iii) Even though it had been planned to complete the Contract within 180 days from the commencement, the completion of constructions had been delayed by 136 days whereas liquidated damages amounting to Rs.1,762,016 had not been recovered for the said delay.
- (iv) The following deficiencies in constructions were observed in the field inspection carried out on 25, 26 and 27 October 2017.
- ❖ The foundations and pillars had been constructed without obtaining reports of soil tests and those were not up to the standard, thus all the walls of entire building had developed cracks. Further, slabs, beams and granite work tops had cracked and separated.
  - ❖ Even though a sum of Rs.2,542,000 had been spent for the supply and installation of all doors, windows, flashings and valance boards, those were not up to the standard.
  - ❖ As the contract for the construction of roof had been awarded on Lump Sum basis, a sum of Rs.464,900 had been overpaid to the contractor.
  - ❖ A Kumbuk flooring of 100 square meters in extent completed at a cost of Rs.959,500, had come off while the stone wall and the parapet wall constructed at a cost of Rs.3,081,568 had developed cracks and separated in most of the places due to failure in constructing them up to the standard.
- (v) The building had been utilized after a delay of one year and 04 months since the completion of the construction of building.

#### **4.8 Staff Administration**

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The following observations are made.

- (a) Even though the approved cadre for Primary Level (Skilled) of the Company had been 163, the actual staff stood at 184, thus 21 officers had been employed without the approval of the Department of Management Services.
- (b) Five officers had been recruited as Stores Assistants under contract basis on 01 June 2016 and out of them, four officers had been employed in a Soya Project implemented under the Minister's office in the Anuradhapura District while one officer had been employed as the Karyala Karya Sahayaka of the Office of the Working Director of the Company. Further, sums totalling Rs.425,333 and Rs.350,578 had been spent by the Company for their salaries respectively in the year under review.

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

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##### **5.1 Tabling of Annual Reports**

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The Annual Report for the year 2015/2016 had not been tabled in Parliament even by 31 October 2017.

##### **5.2 Budgetary Control**

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Variances ranging from 99 per cent to 281 per cent were observed between the budgeted and the actual income and expenditure of 113 items in the year under review, thus it was observed in audit that the budget had not been made use of as an effective instrument of management control.

#### **6. Systems and Controls**

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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.

<b>Areas of Systems and Controls</b>	<b>Observations</b>
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(a) Staff Administration	Failure to make the recruitments of employees properly.
(b) Contract and Procurement Procedure	Failure to follow the Procurement Procedure.
(c) Assets Control	Failure to utilize the underutilized assets.
(d) Budgetary Control	Failure to prepare a Budget in a realistic manner.
(e) Maintenance of Books and Registers	Failure in Properly maintaining the books and registers to be maintained in terms of the Companies Act and for accounting.