

Lanka Sugar Company Private Limited - 2016

The audit of the financial statements of the Lanka Sugar Company Private Limited (“the Company”) for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of comprehensive income, 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. This report is issued in terms of provisions in Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

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 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 judgment, 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 Board, as well as evaluating the overall presentation of the 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

The Lanka Sugar Company Private Limited is a limited liability Company incorporated under the Companies Act, No. 07 of 2007 on 24 August 2012. The 100 Percent ownership of the company belongs to the Government.

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 Lanka Sugar Company Private 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.

2.1.1 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 of opinion and scope and limitations of the audit are as stated above .

- (b) - 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, and
 - the financial statements of the Company comply with the requirements in Section 151 of the Companies Act, No. 07 of 2007.

2.2 Comments on the Financial Statements

2.2.1 Sri Lanka Accounting Standards

Revaluation has not been done for the fixed assets amounting to Rs. 760,763,929 which was acquired by Distillery Section of the Pelwatta Sugar Company in year 2012.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a) Obsolete and unusable assets of the Sevanagala Factory had not been separately identified and accounted for. Hence, the value of assets shown in the financial statements for the year under review had not been fairly presented in the financial statements.

- (b) Provisions for audit fees for the year under review had not been made in the financial statements.

- (c) Some stock items shown in negative value as Rs. 81,655,315 in the books of accounts of the Sevanagala Sugar Company that value had been deducted and had been brought to the financial statements for the year under review.

- (d) According to the calculations made by audit, the deferred tax liability was Rs. 153,121,987. Instead, it was shown in the financial statements as deferred tax assets amounting to Rs. 92,167,028.
- (e) Age analysis for the receivable from farmers amounting to Rs. 276,727,945 mentioned in the financial statements of Sevanagala Sugar Company had not been prepared and write off of bad debts for the unrecoverable amount or provision for doubtful debt had not been made thereon.

2.2.3 Lack of Evidence for Audit

 The following observations are made.

- (a) To confirm the balance of Rs. 19,168,293 receivable from relating party shown in the financial statements evidence not furnished to audit.
- (b) No audit evidence were available to verify the completeness and accuracy of account balances in the amalgamated financial statements of the Company since the adjustments made on the financial statements of Pelwatta and Sevanagala had not been provided for the audit.
- (c) Income tax computation had not been presented to the audit to verify whether, it sufficient to the current year income tax provision amounting to Rs. 177,050,274.

2.3 Accounts Receivable and Payable

 Actions had not been taken to recover and settle the long outstanding balances of 08 receivable accounts items amounting to Rs.339,630,179 and balances of 10 payable accounts items amounting to Rs.423,593,599 respectively.

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

 The following instances of non-compliance with laws, rules, and regulations are observed in audit.

Reference to Laws, Rules and Regulations etc., Non-compliance

(a) Companies Act No:07 of 2007

(i). Section 131

Even though Annual return for the financial year 2015 shall be completed within 30 working days from the date of the Annual General Meeting and the Company shall forthwith forward to the Registrar a copy of the return, signed both by a director and the secretary of the Company, Company had not been comply with this.

(ii). Section 133

Even though the board of the Company shall call an annual general meeting of shareholders to be held once in each calendar year not later than six months after the balance sheet date of the

Company and not later than fifteen months after the previous annual general meeting.

- (b) Section 17(1)(a) of the Employees' Trust Fund Act, No.46 of 1980 Even though the ETF contribution should be paid from the total earnings of the employee, the contribution for the employees who worked at head office has been paid only from the basic salary.
- (c) Section 10(2) of the Employees' Provident Fund Act, No.46 of 1998 (Revised) Even though the EPF contribution should be deducted from the total earnings of the employee, the contribution for the employees who worked at head office has been paid only from the basic salary.
- (d) Public Enterprises Circular No. PED/12 dated 02 June 2003 Paragraph 9.3.1 Even though, every institution should have a scheme of recruitment, No approved scheme of recruitment has been available for the Head office of the Company including Pelwatta and Sevanagala factories.

2.5 Transactions not supported by Adequate Authority

The following matters were observed.

- (a) Pelwatta Sugar Company has purchased a cane loading machine on 23 August 2016 for Rs.13,490,010 and ten tractors on 28 November 2016 for Rs.30,524,000 without following the procurement procedures stated in procurement guideline and without obtaining the approval of Board of directors. Further the total cost estimates has not been prepared for this.
- (b) Four project coordinators and three drivers have been recruited for the head office of the Company on contract basis during the year under review without obtaining the approval of Board of directors or Department of Management Services. However no any project started or coordinated by those officers salaries and allowances paid for them during the year under review was Rs.2,984,552.
- (c) A project manager for the head office of the Company has been recruited for a monthly salary of Rs.150,000 by Chairman without obtaining the approval of Board of directors and approval of Department of Management Services. Even though no project has been started, salary for the last five months of the year under review amounting to Rs.711,290 has been paid on behalf of this officer.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Company for the year under review amounted to a surplus of Rs.873,073,391 as compared with the Corresponding deficit of Rs.1,050,827,240 for the preceding year, thus indicating a increase of Rs.1,923,900,631 in the year under review as compared with the preceding year. Increase of turnover by Rs.2, 847,252,602 that is 58 per cent had been the main reason for the above increase of financial results.

3.2 Analytical Financial Review

The following matters were observed.

- (a) 99 per cent from the total revenue of Rs.7.8 Billion has been comprised of operating revenue. Rs.5.5 Billion from the total operating expenses of Rs.6.8 Billion has been comprised of cost of sales.
- (b) The current ratio and quick ratio of the company for the year under review was 2.17:1 and 1.21:1 respectively. Previous year it was 1.82:1 and 1.17:1 respectively. Fixed deposit amount of Rs.1,327 Million had been included in the current assets during the year under review is the main reason for this favourable liquidity position.
- (c) The Gross profit ratio for the year under review was 28 per cent and the net profit ratio was 13.1 per cent. Previous year it was negative 4 per cent and negative 22 per cent respectively and sales of the Company had been increased by 58 per cent was the main reason for this increase of profitability.

3.3 Working capital management

Interest of Rs.49,837,683 had been paid during the year under review for the bank overdraft amounting to Rs.529,528,543 shown in the financial statements. It is observed that working capital management is not in favourable condition due to higher interest payment for short term loans.

4. Operating Review

4.1 Management activities

Following observations were made.

(a) Pelwatta Sugar Company

- (i) The club house and guest house which was making continuous losses has been established as separate profitable unit by spending Rs.28,163,089 for refurbishment in order to earn additional revenue .Refurbishment had not been completed within the

year 2014 even though it should be completed during that year. However this club house and guest house had been generating losses until the end of year 2016 and Company had not been obtained the benefit against the cost incurred on that.

- (ii) A cane unloading system which was procured at cost of Rs.128, 910,000 under lease facility in the year 2013 without following the Government procurement guideline was not in usable condition due to not installing it in agreed manner in the factory premises. But lease installments and interest amounting to Rs.28, 509,183 had been paid during the year under review and the installments payable including interest for three more preceding years was Rs.48,903,588 and then it was observed that this is an unproductive expense.

(b) Sevanagala Sugar Company

- (i) Environmental protection license had not been obtained by the factory and the distillery for the production of Sugar and Ethanol in terms of National Environment Act No: 47 of 1980. Even though the contract had been awarded to complete the construction of waste water treatment plant for Rs.27,067,812, it had not been completed even as at the end of the year under review. Therefore, the environment license required for the Industry could not be obtained.
- (ii) Alcohol flow meter used to issue ethanol to buyers of the Company had been procured at a cost of Rs.1, 951,019 from a private Company in year 2013. Company had purchased this meter without checking the performance of this meter is in proper manner. Even though the meter had not given correct measurement data, action had not been taken by management to resolve this issue.

4.2 Operational activities

Following observations are made.

(a) Pelwatta Sugar Company

- (i) The sugar factory was not operating at maximum capacity from the year 2012 even though the maximum crushing capacity per day was 600,000 metric tons of cane (3000 MT per day × 200 days of operation per year). Though the total cane crushed for the year 2016 was 416,340 Metric tons, the unused capacity was 183,660 Metric tons which was 31 per cent of the total capacity. Therefore it was observed action had not been taken by management to operate the factory at maximum capacity.
- (ii) Even though the main product obtained from the sugar cane is sugar and producing Ethanol as its by product, in addition to that management has not paid any attention to produce other by products and to increase the company's profitability.
- (iii) Required energy for the distillery has been produced by using bagasse and if it is not enough, furnace oil is used to operate factory machines. For that in year 2016, Company has been expensed Rs.122,496,000. However action has not been taken by

the company to reduce this cost by using alternative energy source or increase production of bagasse or modernize boilers in order to increase the additional energy.

(b) Sevanagala Sugar Company

- (i) As per the Pelwatta Sugar Company, this Company has been expensed Rs.159,882,624 during the year 2016 to produce energy but action had not been taken to reduce relevant cost.
- (ii) The quality of the ethanol produced by the Sevanagala Sugar Company is below standard level due to higher impurity content in molasses and not enough distillation columns in distillery section. So that the Ethanol Selling price of Sevanagala sugar Company is lower than the selling price of ethanol produced by Pelwatta sugar Company. However suitable action had not been taken by the company to improve the quality of Ethanol produced by Sevanagala sugar Company.

4.3 Transactions of contentious nature

Following observations are made.

- a) Even though the Pelwatta and Sevanagala Sugar Companies had been vested to the Company as per the Cabinet decision dated 08 August 2014, Kanthale and Hingura Sugar Industries were in idle as these were not vested to the Company and the Operations of the Kanthale Sugar Company is still inactive.
- b) Immovable properties such as Land , building belonging to Pelwatta and Sevanagala Sugar Companies had been taken over by the government in terms of the provisions in the Act of Revival of Underperforming Enterprises or Underutilized assets No: 43 of 2011. However other movable assets had been used for day to day operations by the Company without take over. But the list of assets transferred to the Company had not with the company. The fixed assets shown under the assets which were belong to two companies could not be identified separately.

4.4 Uneconomic transactions

No agreement has been made on the Building belongs to Pelwatta sugar Company given to the Bank of Ceylon Pelwatta Branch. Action had not been taken by the Company to charge rent on the usage of that building and the electricity and water bills paid by the company on behalf of the bank.

4.5 Staff administration

Without recruiting permanent employees, officers of managerial level had been recruited on short term contract basis and those appointments had been extended again and again.

5. Good Governance and accountability

5.1 Presentations of financial statements

In terms of section 6.5.1 of Public Enterprises circular No: PED/12 dated 02 June 2003, Even though the Draft Annual Report and Accounts should be rendered to the Auditor General within 60 days after the close of the financial year , Draft financial statements had been rendered by the Company on 23 March 2017.

5.2 Internal Audit

Internal audit had not been carried out cover the sugar factory and operational activities of the distillery by the internal audit division of Sevanagala Sugar Company.

5.3 Procurement plan

The procurement plan had not been prepared by the Company in terms of section 4.2.1 of the government procurement guidelines 2006.

5.4 Budgetary Control

Even though in terms of section 5.2.5 of Public Enterprises circular No: PED/12 dated 02 June 2003, Copies of the final updated Budget approved by the Board should be forwarded to the Auditor General not later than 15 days before the commencement of the ensuing year, Company had not been rendered such a copy of annual Budget prepared for the year 2017.

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
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(a) Cost and Financial Accounting	Not follow proper cost and financial accounting system.
(b) Stock Controls	Provisions or written off had not been made by preparing age analysis and identifying obsolete stocks.
(c) Receivable and payable Accounts	Provisions had not been made for bad debts and doubtful debts function of a debtor age analysis and also actions had not been taken to settle long outstanding balances and payables.
(d) Human Resources Management	Approved Recruitment Procedure was not made available and Personal files of old officers of Sevanagala sugar company had not been maintained
(e) Procurement	Instructions in the procurement guidelines had not been followed.