Ceylon Petroleum Storage Terminals Limited (CPSTL) – 2017

The audit of financial statements of the Ceylon Petroleum Storage Terminals Limited ("the Company") for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of 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. This report is issued in terms of 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 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 judgments, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of 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 Basis for Qualified Opinion

The following observations are made.

(a) A difference of Rs. 670.93 million was observed between the amounts shown as receivable from the Ceylon Petroleum Corporation (CPC) in the financial statements of the Company and the corresponding amount shown as payable in the financial statements of the CPC at the end of the year under review and this included a dispute balance of Rs. 548.66 million as at on that date. However, only a provision of Rs.163.62 million had been provided for impairment in the financial statements.

(b) According to the balance confirmation received from the Lanka Indian Oil Company (LIOC), the amount payable to the Company was Rs. 432.77 million, whereas according to the financial statements of the Company the corresponding amount was shown as Rs. 475.40 million. Therefore, an un-reconciled difference of Rs. 42.63 million was observed between those two balances.

(c) The basis for provision of Rs. 142.92 million made on inventory items had not been disclosed in the financial statements or was not made available for audit.

(d) A difference aggregating to Rs. 436.78 million was observed between the Income Tax and Value Added Tax (VAT) payables and VAT recoverable account balances appeared in the financial statements of the Company and the corresponding amounts shown in the records maintained by the Department of Inland Revenue as at the end of the year under review. Therefore, the accuracy, completeness and existence of those balances were doubt in audit.

(e) The recoverability of overpaid Pay As You Earn (PAYE) tax and input VAT amounting to Rs.6.8 million and Rs. 8.06 million respectively was in doubt since these were unrecovered from the year 2008 and 2010 respectively. However, no provision had been made in this regards even as at the end of the year under review.

(f) The reliability of payable balance of Withholding Tax (WHT) and output VAT amounting to Rs. 19.09 million and Rs. 13.91 million respectively was also in doubt since these were continuously carried forwarded year by year in the financial statements for longer period without being settled.

(g) Fully depreciated assets approximately costing Rs. 5,045 million are being continuously used by the Company without reassessing the useful economic lifetime of those assets and accounted them accordingly as per the provisions in LKAS 16. Further, the Company had not revalued its assets since the inception of the Company and a proper revaluation policy was not established for this purpose. Hence, the non-current assets shown in the financial statements had not reflected the fair value of such assets.

(h) Four transactions aggregating to Rs.36.3 million which should be treated as prior year adjustments in the financial statements as per LKAS 08 had been erroneously recognized as transactions of the year under review. As a result, the profit for the year under review had been overstated by Rs. 19.12 million.

(i) It was observed that, more than 250 types of inventory items with huge quantities were included to the Enterprise Resource Planning (ERP) system i.e. SAP of the Company without being entered the value of such inventory items to the system. Hence, the accuracy of the valuation and completeness of inventory items could not be relied upon in audit.

2 Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.4 of this report, the financial statements give a true and fair view of the financial position of the Ceylon Petroleum Storage Terminals Limited as at 31 December 2017 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 followings:

a. The basis of 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 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.

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2.2 Non- compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliances with Laws, Rules, Regulations and Management Decisions, etc. were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a) Public Enterprises Circular No. PED/12 of 2 June 2003	
i. Guideline 4.2.2	Monthly Performance Statement in financial and physical terms, Operating Statement, Cash Flow Statement, Liquidity position and borrowings and Statement on Human Resources including cadre positions, new recruitments had not been tabled at every monthly Board Meeting.

ii.	Guideline 4.3	Minutes of Board meetings had not been forwarded to the Secretary to the line Ministry within 10 days after confirmation of such meetings.
iii.	Guideline 5.1.1	The Company should prepare a corporate plan for 3 years and update it annually as a rolling plan. The copies of plan approved by the Board together with the updated Annual Budget should be forwarded to the Line Ministry, Department of Public Enterprises, and the Auditor General 15 days before the commencement of financial year. However, the Company had not complied with that requirement.
iv.	Guideline 5.2.2 (a)	A feasibility study had not been done before incorporation of capital expenditure which exceeded Rs.10 million in the capital budget.
v.	Guideline 5.2.2 (b)	Approval of the Ministry and the concurrence of the Department of Public Enterprises, had not been obtained for the capital expenditure over Rs.10 million and forty two vehicles acquired in 2017.
vi.	Guideline 5.2.4 and 5.2.5	The draft Budget had not been placed before the Board of Directors for approval three months before the commencement of the financial year. Further, Copies of the finally updated Budget approved by the Board had not been forwarded to the Line Ministry, the Department of Public Enterprises, and Auditor General as specified by the Guideline.
vii.	Guideline 7.4.2	A Senior Management Committee had not been established by the Company.

viii.	Guideline 9.2	The Company does not have an organization Chart registered with the Department of Public Enterprises, with an approved cadre. In the event of creation of a new cadre, or instances where there is excess cadre, the Company had not taken action in consultation with the Department of Public Enterprises.
ix.	Guideline 9.3	The Scheme of Recruitment and Promotion that had been adopted by the Company had not been approved by the Board and the Ministry with the concurrence of the Department of Public Enterprises.
x.	Guideline 9.12	The approval for the Welfare Scheme of the Company had not been obtained from the Department of Public Enterprises.
(b)	Government Procurement Guidelines -2006	The procurement procedures had not been followed when selecting outside transporters and the Board approval had not been obtained.
(c)	Public Enterprises Circular No. FP/06/35/02/01 of 04 November 2013 and No. PED 03/2016 of 29 April 2016.	The Company had borne the Pay As You Earn (PAYE) tax of its employees amounting to Rs. 176.6 million without deducting it from their personal emoluments for the year under review.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company for the year under review had resulted in a pre-tax net profit of Rs.3,273.3 million as compared with the corresponding pre tax net profit of Rs.2,330.1 million for the preceding year, thus indicating an improvement of Rs.943.2 million in the financial results. Increase of throughput revenue as a result of the increase of demand, increase of transport income and finance income and the slight decrease of the administration and financial expenditures as compared with the previous year were the main reasons for this improvement in the financial results.

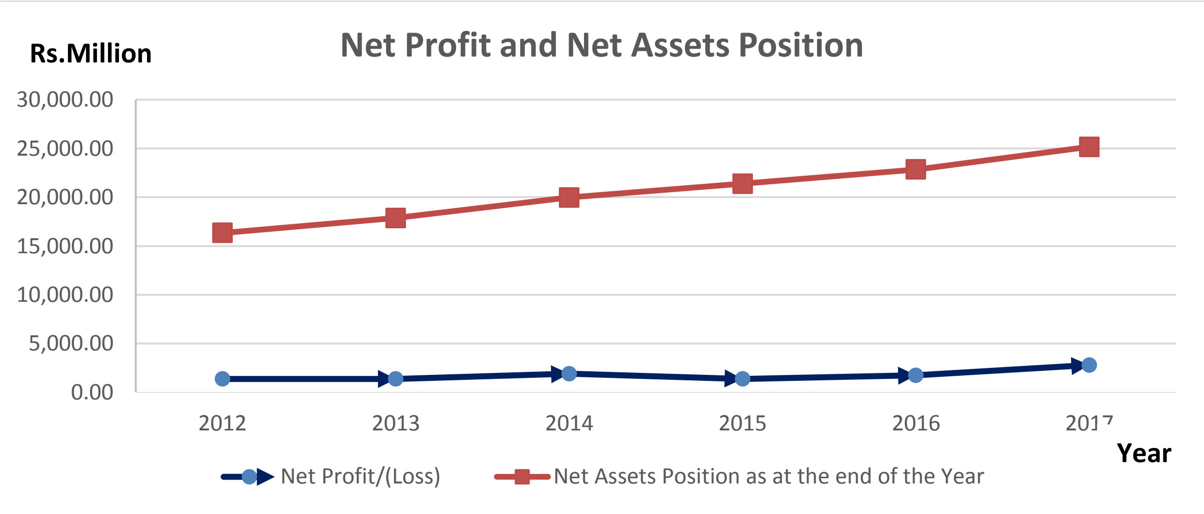
3.2 Analytical Financial Review

3.2.1 Profitability

The operations of the Company had resulted in a markup (Gross Profit/Direct Cost) of 91.55 per cent for the year under review thus indicating an improvement of 1.66 per cent as compared with the markup of 89.89 per cent in the preceding year. Similarly, the gross profit for the year under review had increased by Rs.781 million or 13.03 per cent as compared with the corresponding gross profit of Rs.5,994 million in the preceding year.

3.2.2 Net Profit Vs. Net Assets

The net profit and the net assets of the Company for the year 2017 and previous five years are depicted in the chart shown below.



The net profit had increased by Rs.1,060.95 million or 61 per cent and Net Assets had increased by Rs.2,312.38 million or 10.1 per cent in the year under review as compared with the preceding year.

3.2.3 Significant Accounting Ratios

According to the information made available, some important accounting ratios of the Company for the year under review and the preceding year are as follows.

Ratios	2017	2016
Profitability Ratios		
Gross Profit Ratio (%)	47.79	47.34
Operating Profit Ratio (%)	22.63	19.00
Net Profit/ (Loss) Ratio (%)	19.75	13.73

Liquidity Ratios		
Current Ratio (Number of times)	5.47:1	5.25:1
Quick Ratio (Number of times)	4.88:1	4.57:1
Working Capital (Rs. million)	10,455	8,752
Investment Ratio		
Return on Assets (ROA) (%)	9.75	6.79

The following observations are made in this regard.

(a) The gross profit ratio and the net profit ratio had improved by 0.95 per cent and 43.84 per cent respectively during the year under review as compared with the previous year.

(b) The working capital position of the Company had improved by 19.46 per cent in the year 2017 as compared with the previous year. The main contributory factors for this improvement were the increase of trade and other receivables and the decrease in borrowings.

(c) The return on Assets (ROA) of the Company had improved by 2.96 per cent in the year 2017 as compared with the previous year. The main contributory factors for this positive condition were the increase of revenue of the Company, finance income and the decrease of administrative expenses, finance cost and income tax expense of the year.

4 Operating Review

4.1 Management Activities

The following observations are made.

(a) A Prime Mover, purchased at a cost of Rs.14.9 million was damaged due to an accident happened on 27 May 2017. However, the Company had failed to recover the loss from the responsible parties or by private insurance company which insured the vehicle up to 26 July 2018. As a result, CPSTL was unable to utilize the vehicle over a one year period.

(b) According to the Section 03 of the Settlement Agreement dated 05 January 2007 between the Government of Sri Lanka and Lanka IOC PLC, it was restricted to deliver petroleum products by Lanka IOC from its China Bay installation to a maximum of 5 per cent of the country's throughput of petroleum products and Ceylon Petroleum Corporation (CPC) to a maximum of 5 per cent excluding deliveries from Sapugaskanda Refinery. However, a regular process was not available to monitor the compliance to above conditions. As a result, there is a possibility of losing throughput income to the Company.

(c) It was noted that Shareholders Agreement & Share Sale Purchase Agreement for the common user facility between Ceylon Petroleum Corporation, Lanka Indian Oil Company PLC and Ceylon Petroleum Storage Terminals Limited was expired on 31 December 2008. Neither an extension been obtained, nor a new agreement was entered. Therefore, the pricing formula used for the purpose of determining the throughput charges and transport income including slab recoveries had not been revised since year 2011.

(d) Transport charges payables aggregating to Rs.33,218,818 relating to 273 vendors and other creditors aggregating to Rs.79,486,450 shown under other payables as at 31 December 2017 had remained outstanding over a period ranging from one year to six years without taking favourable actions to settle.

(e) Having a proper agreement between parties who provide any support services to an organization for smooth running of the business and minimizing the cost is needed. However, an agreement or even a Memorandum of understanding (MOU) had not been entered into with CPC and Lanka IOC. As a result, the procedures and roles and responsibilities of each party could not be properly defined.

(f) It is important and beneficial to the Company to keep a track record of controls in place for each process of the Company to ensure that the management prescribed/designed process is operating without exceptions. Further, once a procedure manual is designed it should be periodically evaluated at reasonable intervals to ensure its relevance. However, It was observed that a written procedure manual was not available showing the controls that are in place to prevent and detect internal control weaknesses or any possible errors and irregularities that could occur.

(g) According to the Section 56(2) of the Companies Act No. 07 of 2007, the Board of Directors of the Company should obtain the Solvency Certificate from the auditors before distributions to the shareholders. According to the Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka, the auditor of the Company is the Auditor General. The following observations are made in this regard.

(h) According to the Board Decision No. 1/182 dated 15 March 2018, the Board had approved to pay interim dividend of Rs.651 million subject to obtain the Certificate of Solvency from the Auditor. However, such Solvency Certificate had not been obtained from the Auditor General. Further A Directors' Statement of Solvency was received to the Auditor General on 20 March 2018. However, the requested information to verify the solvency of the Company up to the date of the decision for distribution of dividend were not submitted to the audit even two reminders were sent.

(i) In the meantime, the Company had paid Rs.651 million as an interim dividend to its shareholders getting a third-party solvency report from an audit firm in public practice, in contrary to the provisions in the Companies Act and the consent of the Auditor General for appointment of an audit firm in public practice to get the service was not obtained. Further, the approval of the Board had not been obtained to appoint an audit firm in public practice to obtain the service of solvency assessment. Also, according to the information made available, a formal appointment letter had not been issued to said auditors.

4.2 Operating Inefficiencies

It was noted that a single pipe line was used by the Company to transfer finished petroleum products from the Colombo Port to the Kolonnawa Petroleum Installation.ie: one pipe line is used for the transfer of Black Oil and another Pipeline is used to transfer white oil. This pipe lines had been used for about 50 years. Dependence on a single pipe line may result to interruption to the fuel distribution, if any major repairs occur.

In response to above issue raised in previous year, the management of the Company stated that "*action has been taken to install two new pipe lines of 18" & 14" diameters for white oil and black oils respectively. 85 per cent of the work completed on replacement of 12" dia. Pipeline and intend to complete 100 per cent by end of March 2018".* However, it was not completed even up to 13 August 2018.

4.3 Resources of the Institution given to Other Government Institutions

In contrary to the instructions of the Circulars, particularly, the Public Enterprises Circular No. PED/12 of 02 June 2003 on Public Enterprise Guidelines for Good Governance, the Letters Nos. CSA/PI/40 of 04 January 2006 and CS/1/17/1 of 14 May 2010 issued by His Excellency the President, and the Public Enterprises Circular No.21 of 08 January 2004, the Company had released 04 persons and 04 vehicles to other institutions and incurred Rs.2,767,777 on payment of remuneration and other allowances on behalf of released employees and payment of fuel and maintenance expenses for released vehicles.

4.4 Human Resources Management

The following observations are made.

(a) Out of the approved cadre of 3,249 of the Company, 172 posts or 5.3 per cent were in vacant as at 31 December 2017. Out of that, 54 posts or 31 per cent were in senior staff level including Deputy General Manager, Operations, Chief Information Officer, Senior Deputy Manager, Distribution and Engineering Manager etc... Further, it was observed that, Thirty one positions in that level were being vacant for 8 to 48 months as at the end of the year under review.

(b) According to the information provided to the audit, even though 37 paper and website advertisements had been published for the recruitment of 37 posts including twenty three posts in Grade A, only one post in Grade A had been recruited up to 22 May 2018. The reasons for not filling the balance vacancies were not clear to audit.

(c) Eighteen persons had been recruited for 05 posts within the year without publishing the vacancies, in contrary to the Scheme of Recruitment and Promotion of the Company.

(d) According to the Board Decision No. 27/177 dated 24 October 2017, the Deputy General Manager (Finance) had been sent for compulsory leave on 31 October 2017. However, According to the information provided to the audit, a sum of Rs.2,071,101 had been paid to him for the period from November 2017 to May 2018 as salaries including professional allowance, fuel allowance, house rent and meal allowance. In addition, annual bonus totalling to Rs.449,846 had been paid by the Company which comprise Rs.184,454 for the year 2017 and Rs.265,392 for the year 2018. The reason for paying salaries including above allowancess and bonuses was not assured in audit to that employee who was in compulsory leave. Further, functioning of the Company without Head of Finance over a one year period would create troubles in its smooth running. Therefore, the reason for not filling the above post for longer period either by expediting above inquiry or other ways is not clear to audit.

5 Achievement of Sustainable Development Goals

Every public institution should act in compliance with the United Nations Sustainable Development Agenda by year 2030. With respect to the year under review, the Ceylon Petroleum Storage Terminals Limited had not been aware as to how to take measures relating to the activities under the purview of their scope.

Consequently, the Ceylon Petroleum Storage Terminals Limited was failed to take actions to identify the sustainable development goals and targets relating to the activities thereof, along with the milestones in respect of achieving those targets, and the indicators for evaluating the achievement of such targets.

6 Accountability and Good Governance

6.1 Internal Audit

Internal audit function provides a number of important services to the management of any organization. These include detecting and preventing fraud, testing internal control, and monitoring compliance with organization’s policies and government regulations. Therefore, internal audit function plays a vital roll in the development of the organization. The following observations are made about the internal audit function of the Company.

(a) An internal audit procedure or manual had not been introduced by the Company.

(b) The approval of the Board to the internal audit plan for the year 2017 had not been obtained and no proper risk assessment had been made as to cover all the risk areas by the Internal Audit Division.

(c) The observations and recommendations of the internal audit have not regularly been evaluated and reported to the Board of Directors of the Company.

6.2 Budgetary Control

The annual budget of the Company for the year 2017 had been approved by the Board on 11 August 2017 after the 07 months of the financial year. Therefore, it seems that the Company had failed to use the budget as an effective financial control mechanism during the year under review.

7 Systems and Controls

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

Area of Control	Observation
(a) Human Resources Management	The Scheme of Recruitment and Promotion that had been adopted by the Company had not been amended appropriately and approved formally.
(b) Utilization of Resources	Non-compliance with the circular instructions in deploying the resources.