Lanka Coal Company (Private) Limited – 2017

The audit of the financial statements of the Lanka Coal Company (Private) 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. My comments and observations on the performance of the company which I consider should be furnished to the 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's Responsibilities 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 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 qualified audit opinion

1.4 Basis for Qualified Opinion

(a) Value Added Tax (VAT), Economic Service Charges (ESC) and Withholding Tax aggregating Rs.27,478,787 and Tax payable Rs.11,703,151 had been shown as receivables and payables respectively under Note 15 and 20 to the financial statements. In the meantime, abnormal debit balances of Rs.3,371,326 and Rs.12,758,801 had been shown as Nation Building Tax (NBT) and VAT respectively under the creditors in the financial statements. During the audit these balances could not be satisfactorily verified in audit due to non-availability of sufficient and appropriate audit evidence such as details of tax computation and tax returns etc. Further, the Company had not taken effective action to clear those balances by negotiating with the Department of Inland Revenue even up to the date of this report.

(b) As per the Note - 22 to the financial statements, the income tax liabilities as at the end of the reporting period was Rs. 65,474,540. However, it was shown as Rs.4, 046,601 in the records of the Department of Inland Revenue. Hence, the income tax liability shown in the financial statements had been overstated by Rs.61, 427,939.

(c) The Company is liable to pay ESC on the value of coal supplied to the Ceylon Electricity Board. However, the Company had failed to make a provision of Rs. 159,790,628 in this regard in the financial statements.

(d) According to the Value Added Tax (Amendment) Act, No.20 of 2016, the VAT exemption granted on “importation and supply of coal” had been removed with effect from 01 November 2016. Therefore, the Company is liable to pay VAT on importation and supply of coal. However, the Company had not been accounted the input VAT and output VAT amounting to Rs.5,071,823,613 and Rs.4,790,535,258 respectively. Further, disallowable VAT amounting to Rs.281,288,355 had not been treated as expense of the year under review. As a result, Cost of Sale had been understated by same amount. And also, disallowable VAT amount had not been invoiced by the Company to the Ceylon Electricity Board. Therefore, the revenue of the Company had been understated by Rs. 281,288,355 and tax liability thereon amounting to Rs.42,193,253 had not been recorded.

(e) According to the detailed schedule submitted to audit, the Note -19 to the financial statements included an amount of Rs.478,179,795 as payable to Ceylon Electricity Board. However, as per the Note – 10 to the financial statements, the corresponding amount was as Rs. 539,192,079 from Ceylon Shipping Corporation Ltd with regard to short delivery of coal and other receivables. Hence, an un-reconciled difference of Rs.61,012,284 was observed between those two figures. However, the Company had failed to recover this receivable balance from Ceylon Shipping Corporation Ltd, even though five years has been passed from the transaction date. The recoverability of the above mentioned balance could not be ensured in audit and the entity has not recognized provision for above mentioned receivable balance, hence it is affect to the fair presentation of the financial statements.

2 Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in basis for qualified opinion paragraph the financial statements give a true and fair view of the financial position of the Company 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 :

- Except for the effects of the matter described in basis for qualified opinion paragraph, 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.

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

Instances of non-compliance observed in audit are given below.

	Reference to Laws, Rules and Regulations etc.	Non-compliance
(a)	Public Enterprises Circular No. PED /12 dated 02 June 2003	The Company had reimbursed a sum of Rs.1,144,193 as medical expenses to the staff during the year under review without an approved Medical Scheme.
(b)	Public Enterprises Circular No. 05/2016 dated 16 December 2016	Approval of the General Treasury should be obtained prior to the payment of bonus to the employees of fully government owned companies. However, LCC had paid a sum of Rs.1,331,006 as bonus for the financial year ended 31 December 2017 without obtaining the approval.
(c)	Public Enterprises Circular No. 95 dated 14June 1994	A sum of Rs.1,199,510 had been paid by the company to the staff for leave encashment without

		obtaining a proper approval.
(d)	Government Procurement Guidelines– 2006 (NPA Circular No: (08))	
	(i) Guide Line 8.9.3	Coal procurement agreements, exceeding the value of Rs. 500 million, had been signed by the Chairman of the Company instead of being signed by the Secretary to the Line Ministry.
	(ii) Guide Line 8.8	Even though the unsuccessful bidders should be informed of their shortcomings in brief with the overall objective of educating the bidders to submit more responsive and competitive bids in future, it had not been done.
(e)	Inland Revenue Act No: 10 of 2006	(i) A provision had not been made by the company for the payable tax amounting to Rs.592,244 on the interest income for the year under review. (ii) A provision for income tax had not been made for the years 2016 and 2017. (iii) Self assessments of the income tax had not been done by the company for the year 2017/2018. (iv) Income tax returns for the years of assessment 2015/2016 and 2016/2017 had not been sent to Department of Inland Revenue, on due dates.
(f)	Economic Service Charges Act of No. 13 of 2006	(i) Economic Service Charges payable for the year of assessment 2017/2018 amounting to Rs. 159,790,628 had not been paid by the Company and a provision had not been made in the accounts as well. (ii) Economic Service Charge Returns for the year of assessment 2017/2018 had not been submitted to the Department of Inland Revenue even as at 06 August 2018.

3 Financial Review

3.1 Financial Result

According to the financial statements presented, the operations of the Company for the year ended 31 December 2017 had resulted neither pretax net profit nor net loss as per the preceding year, due to entering into an agreement with the Ceylon Electricity Board to reimburse the net overhead cost incurred by the Company since the previous year.

4 Operational Review

4.1 Performance

4.1.1. Planning

A Corporate Plan and Annual Action Plan had not been prepared by the Company for the year under review as specified by the Public Enterprises Circular No.PED/12 dated 02 June 2003.

4.1.2 Operating and Review

The performance of the Company could not be measured due to an annual profit or loss could not be considered and according to the Articles of Association of the Company the business can be spread over different arrears. However, LCC had not expanded its business even in the year under review.

4.2 Management Activities

The following observations are made.

(a) The Company had made an overpayment of Rs.233,193,318 in the years 2015 and 2016 respectively because of including inaccurate price adjustments formulas in the coal supply agreement entered into between the Company and the Liberty Commodities (Private) Limited (LCL). Further Arbitration and High Court cases were being processed and a legal fee incurred during the year under review was Rs.3,435,896 and it had also been reimbursed from CEB.

(b) According to the agreement entered into between the company and CEB, expenses relating to procurement of coal only can be reimbursed. However it was observed that the donation and sponsorship amounting to Rs.325,000 had been granted by the company for the year 2017 without obtaining the approval of the Department of Public Enterprises, General Treasury and without including in to the budget allocation.

4.3 Procurement Management

The following observations are made.

(a) There was no coal purchasing agreement between CEB and LCC for the period from 30 April 2017 to 01 September 2017.

(b) The company had obtained discharge port coal analysis reports from SGS Lanka (Private) Limited since the commencement of the coal supply. However, almost all instances coal suppliers had also obtained load port quality analysis reports from a subsidiary of SGS Group. Conditions had not been included in agreement. to prevent suppliers obtaining quality analysis reports from SGS Group. Obtaining both reports from the same quality analysist of SGS Group may affect to the independency of analyst and accuracy of the reports.

(c) Since total coal requirement for the season 2017/2018 was delivered from South Africa, the applicable coal price index was API 4. But, it was observed that the awarded price for Spot -11 was higher than the applicable API 4 Index. Therefore, total additional cost incurred was Rs. 198,092,544 (USD 1,269,824).

4.4 Transactions in contentious Nature

Although the scope nature and responsibility of the General Manager CEB were expanded than the scope nature and responsibility of the Managing Director of the company a sum of Rs. 289,380 had been paid monthly to the Managing Director as equal as to the salary of the General Manager of the CEB. Further the employees of the Company had been paid salaries in accordance with the salary scales of the Ceylon Electricity Board.

4.5 Human Resources Management

The following observations are made.

(a) Five officers had been recruited in the year under review without having formally approved Scheme of Recruitment (SOR) and without proper selection process by calling applications and holding interviews.

(b) Job descriptions had not been given to some employees when recruiting and instances of changing the duties and responsibilities.

5 Accountability and Good Governance

5.1 Procurement Plan

A Master Procurement Plan had not been prepared by the Company. However, tentative lay can schedules had been prepared based on the annual coal requirement of the Ceylon Electricity Board.

5.2 Internal Audit

An internal audit division had not been established.

5.3 Audit Committee

Only one Audit Committee meeting had been held in the year 2017.

5.4 Social Responsibilities

The bottom ash of Lakvijaya Power Plant is being dump at the plant premises itself and had become threat to the environment. Therefore, the Company has commenced a project for managing ash disposal in an environmental friendly manner and the product was acceptable according to the tests carried out by the Sri Lanka Standard Institution and Industrial Technology Institute. However, the project has been discontinued 2 years ago due to external factors wasting the funds invested as well as letting the environmental issue to be continued.

5.5 Budgetary Control

The following observations are made.

(a) Significant variances ranging from 20 per cent to 180 per cent with respect to 25 items were observed between the budgeted and the actual figures, thus indicating that the budget had not been made use of as an effective instrument of management control.

(b) According to the Public Enterprises Circular No. PED/12 of 02 June 2003, the Annual Budget should include a budgeted income and expenditure statement, a cash flow statement for the year, a statement of financial position at the end of the year, and a budgeted capital expenditure statement together with an Annual Action Plan. However, the Company had not complied with that requirement.

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 Control	Observation
(a) Accounting	Definencies in accounting of recipts, control over the general ledger and journal entries.
(b) Maintaining Books and Records	(i) Cash or cheque register not being maintained. (ii) receipts not being issued in a searial order.
(c) Payments	Vouchers not being certified properly before making payment.
(d) Debtor /creditor	No proper control over the debtors and Creditors
(e) Segregation of duties	Segregation of duties not being done.
(f) Cash Management	Idle cash balance of Rs.1,234,568 in dormant account