## Ceylon Petroleum Corporation (CPC) – 2017

The audit of financial statements of the Ceylon Petroleum Corporation ("the Corporation") and the consolidated financial statements of the Corporation and its Subsidiary ("the Group") 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 read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 31 of the Ceylon Petroleum Corporation Act, No. 28 of 1961. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2)(c) of the Finance Act appear in this report.

### 1.2 Management's Responsibility for the Financial Statements

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

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 consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 -1810). 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 Corporation'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 Corporation'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. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

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**

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

## 2. Financial Statements

### 2.1 Qualified Opinions

**(a) Opinion – Corporation**

In my opinion, except for the effects of the matters described in paragraph 2.2.2 of this report, the financial statements give a true and fair view of the financial position of the Ceylon Petroleum Corporation as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**(b) Opinion – Group**

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the consolidated financial statements give a true and fair view of the financial position of the Ceylon Petroleum Corporation and its Subsidiary as at 31 December 2017 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### 2.2 Comments on Financial Statements

#### 2.2.1 Group Financial Statements

The following observations are made.

(a) Since there is no agreement between the Corporation and Subsidiary with regard to balance payable (Rs. 6,979.63 million) and receivable (Rs. 7,650.56 million) which arrived from intercompany transactions, a non-eliminated balance of Rs. 670.93 million had remained in the group financial statements.

(b) A qualified opinion had been expressed on the financial statements of the Subsidiary (CPSTL) for the year under review based on the following matters.

(i) 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.

(ii) 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.

(iii) 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.

(iv) A difference of Rs. 436.78 million was observed between the Income Tax, Economic Service Charge (ESC) 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.

(v) 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.

(vi) 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.

(vii) 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 account 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.

(viii) Four transactions aggregating 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 and retain earning as at the end of the year under review had been overstated and understated respectively by Rs. 19.12 million.

(ix) It was observed that, more than 250 types of inventory items with the huge quantity 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.

### 2.2.2 Financial Statements of the CPC

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#### 2.2.2.1 Adherent with Sri Lanka Accounting Standards (LKAS)

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The following observations are made.

(a) Paragraph 11 of **LKAS 2 – Inventories**: All expenditure incurred for bring the stocks to the store should be considered as cost of stock. However, Excise Duties amounting to Rs. 55,327.9 million incurred in the year under review for importation of fuel had been set off against the revenue without being considered as inventory cost. As a result, the actual cost of sales for the year under review and the value of closing inventory had not been shown in the financial statements.

(b) Paragraphs 51 and 36 of **LKAS 16 - Property, Plant & Equipment:** Fully depreciated assets approximately costing Rs. 4,749 million are being continuously used by the Corporation without reassessing the useful economic lifetime of those assets and account them accordingly**.** Further, at a sample audit test check it was revealed that, 15 lands belongs to the Corporations as at the end of the year under review had not been revalued. Therefore, the accuracy of fair value of such assets is doubt in audit.

(c) Paragraph 08 of **LKAS 17 – Leases:** "the lands having only the lease right had been capitalized and revalued by the Corporation in the year under review treated as leasehold asset contrary to the provisions in the Standard.

(d) **LKAS 36 – Impairment:** No evidence was made available for audit to ensure that an impairment test had been conducted by the Corporation for the year 2017. Hence, the accuracy of the fair value of assets is in doubt in audit.

#### 2.2.2.2 Accounting Deficiencies

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The following observations are made.

(a) A balance of Rs. 1,135.8 million had been continuously carried forwarded in the financial statements since the year 2010 as receivable from the Department of Island Revenue and Sri Lanka Customs. However, reasons for continuation of such balances for a longer period were not clear to audit. Further, no provision had been made in this regard in the financial statements in the year under review.

(b) According to the age analysis submitted, an amount of Rs. 753 million receivable from the Ceylon Electricity Board (CEB) had remained outstanding since the year 2013 without taking any recovery action even up to the end of the year 2017. Further, no impairment had been made thereon in the year under review.

(c) According to the confirmation received, an amount of Rs. 3,847.1 million had to be paid by the Corporation to the People's Bank as at the end of the year under review in respect of hedging transactions taken place for procurement of oil during the period of 2007 to 2009. However, it had not been brought to accounts of the Corporation.

**2.2.2.3 Un-reconciled Differences**

Un-reconciled differences of Rs. 206.4 million and Rs. 177 million were observed between the charges for storage and distribution of oil (i.e. terminal charges, transport charges and interest payment etc.) shown in the financial statements of the Corporation and Subsidiary for the year 2017 and 2016 respectively.

**2.2.2.4 Unexplained Differences**

According to the financial statements of the Corporation, net amount payable to the Sri Lanka Customs as at 31 December 2017 was Rs. 7,278,958,430. However, as per the records of Sri Lanka Customs it was shown as Rs. 5,782,668,839 recoverable from the Corporation. However, reasons for difference of Rs. 1,496,289,591 were not explained to the audit.

**2.2.2.5 Lack of Evidence for Audit**

The following observations are made.

(a) Value Added Tax (VAT) aggregating Rs. 423,905,381 was shown under other receivable balance in the statement of financial position at the end of the year under review for longer period. Out of this, amounting to Rs.326,391,518 is continue since 2010. Moreover, the tax invoices and other relevant supporting documents were not made available to audit in this regard. Therefore, the recoverability of those balances is doubt in audit.

(b) Even though neither overpayment nor carried forwarded tax balance had been appeared in any tax return submitted to the Department of Inland Revenue, a sum of Rs.376,000,065 had been continuously carried forwarded in the financial statements since 2010 as receivable from Department of Inland Revenue. Further, it was unable to confirm by alternative means the recoverability of this balance shown under other receivable.

### 2.2.2.6 Accounts Receivable and Payable

Total trade receivables as at 31 December 2017 was Rs. 76,616 million which comprise Rs. 65,979 million and Rs. 10,637 million due from Government institutions and Non-government institutions respectively. The total dues as at the end of the year under review had increased by 129 per cent with compared to the previous year outstanding balance of Rs. 33,387 million. Age analysis of accounts receivable as at 31 December 2017 is shown below.

| Period | Category<br>Government<br>Rs. Million | <br>Non-Government<br>Rs. Million | Total<br><br>Rs. Million |
|---|---|---|---|
| Below one year | 56,867 | 10,240 | 67,107 |
| 1-2 Years | 7,387 | 81 | 7,468 |
| 2-3 Years | 55 | 46 | 101 |
| 3-4 Years | 498 | 236 | 734 |
| 4-5 Years | 832 | 1 | 833 |
| Over 5 Years | 340 | 33 | 373 |
| **Total** | **65,979** | **10,637** | **76,616** |

The following observations are made in this connection.

(a) Recoverable balances of Rs. 52.5 million from two Airlines customers had remained outstanding since the year 2011. Nevertheless, the Corporation is continually supply the fuel to those customers without recovering these long outstanding balances even from current payments made to the Corporation.

(b) The outstanding trade debtor balance recoverable from the CEB as at 31 December 2017 was Rs. 50,255.07 million and it was an increase of 280 per cent as compared with the outstanding balance of Rs.13,223.70 million in previous year. The following observations are also made in this regard.

   (i) As pointed out in previous audit reports, even though the Corporation sells fuel to the CEB for power generation since several years, a formal agreement or MOU between those two parties in order to ensure smooth operation of the individual institutions had not been entered.

(ii) The balance outstanding from the CEB has represented 66 per cent of the total outstanding balance of trade debtors as at the end of the year under review. Out of that, Rs 16,377 million was pertaining to the invoices raised for the year 2017.

(c) As per the financial statements of the year under review, more than Rs.10,530 million interest cost had been incurred by the Corporation for short term Foreign Currency loans taken from Peoples Bank and Bank of Ceylon for fuel importation. Hence, it was observed that if the Corporation is promptly recovered its overdue balances in time, the interest cost of Rs.10,530 million incurred by the Corporation could have been considerably reduced.

(d) The formal agreements for fuel supply had not been entered into with 15 major customers who represent a total outstanding balance of Rs. 53,346.6 million or 70 per cent as at the end of the year under review even it was pointed out in my previous audit reports. Therefore, the default risk with regard to this outstanding balance is at very high level.

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

The following instances of non-compliance were observed in audit.

| Reference to Laws, Rules, Regulations and Management Decisions | Non-compliance |
|---|---|
| (a) Public Enterprises Circular No. PED/12 of 02 June 2003 - Guidelines for Good Governance. | |
| (i) Guideline 4.2.3(b) | The Board had not periodically reviewed the performance of its Subsidiary in order to ensure the achievement of targets of the Subsidiary. |
| (ii) Guideline 4.2.6 | Quarterly Performance Reports had not been forwarded to the line Ministry and the Department of Public Enterprises on or before 30 days before the end of each quarter. |
| (iii) 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 minutes. |

| | | |
|---|---|---|
| (iv) | Guideline 5.1.1 | Even though The Corporation had prepared the Corporate Plan, updated copies of Corporate Plan approved by the Board together with the updated Annual Budget had not been forwarded to Department of Public Enterprises, General Treasury and at least 15 days before the commencement of the financial year. |
| (v) | Guideline 5.2.2(b) | Approval of the Ministry and the concurrence of the Department of Public Enterprises, General Treasury had not been obtained before incurring expenditure for purchase of seven motor vehicles to the cost of Rs 307.8 million during the year 2017. |
| (vi) | Guidelines 5.2.4 and 5.2.5 | (i) The draft Budget had not been placed before the Board of Directors for approval, three months before the commencement of the financial year.<br><br>(ii) Copies of the final updated Budget approved by the Board had not been forwarded to the line Ministry, the Department of Public Enterprises, General Treasury and Auditor General not later than 15 days before the commencement of the year 2017. |
| (vii) | Guideline 7.4.2 | A Senior Management Committee had not regularly met and due to absence of proper records, it was unable to ensure whether such committee has focused at the meeting about the salient matters specified in the Circular. |
| (viii) | Guideline 9.3 | The Corporation does not have a Scheme of Recruitments and Promotions which has been approved by the appropriate Ministry with the concurrence of the Department of Public Enterprise, General Treasury. |
| (ix) | Guideline 9.4 | The Corporation had released 05 employees to other institution in 2017 without the approval of the Cabinet of Ministers and paid emoluments of those released employees out of the funds of the Corporation. |

| | | |
|---|---|---|
| (x) | Guideline 9.12 | The approval for the Welfare Scheme of the Corporation had not been obtained from the Department of Public Enterprises, General Treasury. |
| (b) | Finance Circular No. 124 of 24 October 1997 of the Ministry of Finance and Planning. | Covering up duties of a vacant post should be limited to a period of 03 months. Nevertheless, 29 officers had been assumed for cover up duties of the vacant posts including 18 Grade A posts such as Manager (Investigation), Manager Marketing (Retails), Regional Manager (Central) etc. for the period ranging 06 months to 9 years as at 31 December 2017. |
| (c) | Public Enterprises Department Circular No. FP/06/35/02/01 dated 04 November 2013 and No. PED 03/2016 dated 29 April 2016. | The Corporation had borne the Pay As You Earn (PAYE) tax of its employees amounting to Rs. 53.57 million without deducting it from their personal emoluments for the year under review. |
| (d) | Payment of Gratuity Act, No. 12 of 1983 | The Corporation has computed the provision for gratuity by taking into account the basic salary, the Professional Allowance and 15 per cent of the salary pays as Special Allowance for the employees contrary to the conditions in the Act. |
| (e) | Guideline 4.2 of the Government Procurement Guidelines (2006) | Master Procurement Plan had not been prepared at least for 3 three years by the Corporation |
| (f) | Public Finance Circular No. 04/2015 dated 14 July 2015 and Public Finance Circular No. 437 dated 18 September 2009 | The Insurance Agreement entered into with a private party relating to properties of the Corporation for the year 2017/2018 was in contrary to the provisions in the Circulars. |

## 3. Financial Review

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### 3.1 Financial Results

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According to the financial statements presented, the operations of the Corporation for the year under review had resulted in a pre-tax net profit of Rs. 3,367.2 million as compared with the corresponding pre-tax net profit of Rs. 69,553.7 million for the preceding year, thus indicating a deterioration of Rs.66,186.5 million in the financial results. Non-adjustment of domestic market prices in response to elevated petroleum prices in the global market, continuous depreciation trend of Sri Lankan Rupee against the United States Dollar were the main reasons attributed for this deterioration.

However, A contribution of Rs.153,136 million had been made by the Corporation to the country in the year 2017 after considering the payment of salaries to the employees, payment of taxes and special charges to the Government and the depreciation for non-current assets.

## 3.2 Analytical Financial Review

### 3.2.1 Profitability

The operations of the Corporation had reported in a profit markup of 6.6 per cent for the year under review thus indicating a deterioration of 23 per cent as compared with the profit markup of 29.6 per cent in the preceding year. Hence, the gross profit for the year under review had decreased by Rs. 69,079 million or 71 per cent as compared with the corresponding gross profit of Rs. 96,620 million in the preceding year. The details are summarized in the table given below.

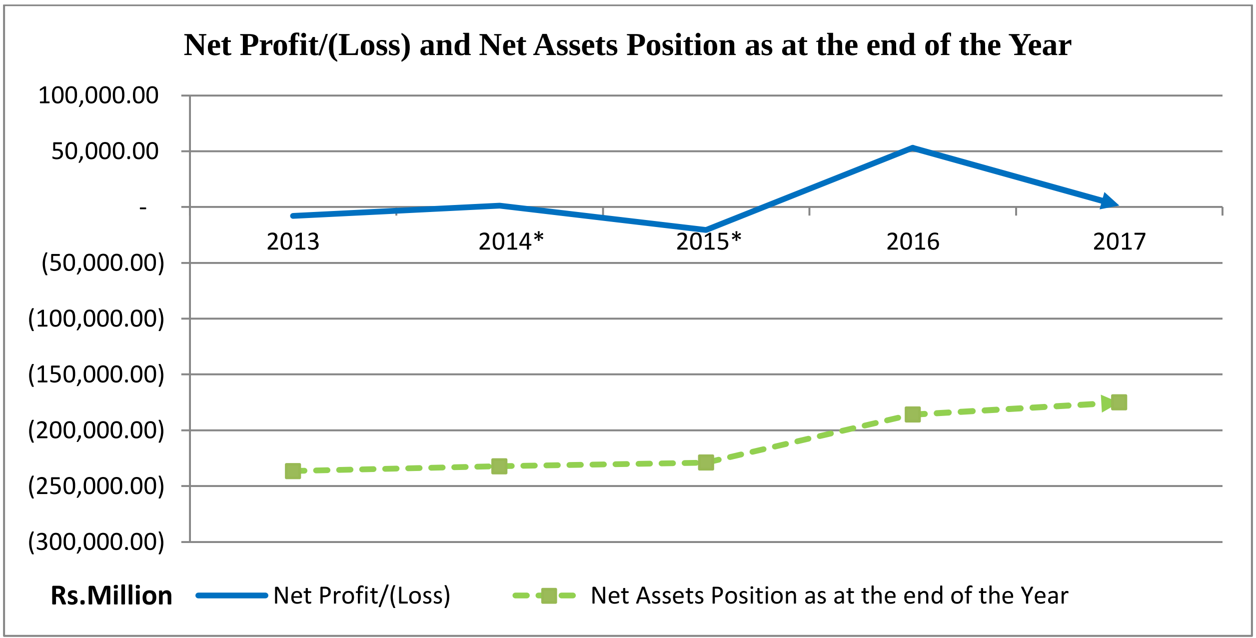
| **Description** | **For the year ended 31 December** | | **Variance {Favourable/ (Adverse)}** | |
|---|---|---|---|---|
| | **2017** | **2016 Restated** | | |
| | **Rs. million** | **Rs. million** | **Rs. million** | **Percentage** |
| Revenue | 446,502 | 423,061 | 23,441 | 5.5 |
| Cost of Sales | (418,961) | (326,441) | (92,520) | (28.3) |
| **Gross Profit** | **27,541** | **96,620** | **(69,079)** | **(71)** |
| Other Income | 670 | 3,589 | (2,919) | (81.3) |
| Selling and Distribution Expenses | (15,498) | (14,412) | (1,086) | (8) |
| Administration Expenses | (4,960) | (4,384) | (576) | (13.1) |
| **Operating Profit** | **7,753** | **81,413** | **(73,660)** | **(90.4)** |
| Exchange Rate Variation | (4,922) | (8,829) | 3,907 | 44.25 |
| Finance Expenses | (10,531) | (11,404) | 873 | 8 |
| Finance Income | 11,067 | 8,374 | 2,693 | 32 |
| Hedging Expenses | - | - | - | - |
| **Profit/(Loss) Before Income Tax** | **3,367** | **69,554** | **(66,187)** | **(95)** |

### 3.2.2 Net Profit/(Loss) against Net Assets

Attention is drawn to the matter that even the operations of the Corporation had resulted in an after-tax net profit of Rs. 1,470 million and a total comprehensive income of Rs. 10,793 million for the year 2017, the Corporation had a negative net assets position of Rs. 175,054 million at the end of the year under review. Nevertheless, the negative net asset position was reduced by Rs 10,211 million in the year under review due to revaluation of several lands of the Corporation in this year. The heavy losses incurred by the Corporation due to Hedging transactions taken place during previous years had caused to this continues negative net assets position. Even though the Corporation had earned a pre-tax net profit of Rs. 3,367.2 million during the year under review, the heavy losses sustained during the previous years had resulted to retain further negative net assets position of the Corporation. As such, the going concern of the Corporation without the financial assistance from the Government is in a contentious issue. The net profit/ (loss) and the net assets position of the Corporation for the year 2017 and previous five years period are depicted in the table and the chart given below.

| Year | Net Profit/(Loss) Rs. million | Net Assets Position as at the end of the Year Rs. million |
|---|---|---|
| 2013 | (7,889) | (236,467) |
| 2014* | 1,129 | (232,257) |
| 2015* | (20,681) | (228,985) |
| 2016 | 53,027 | (185,847) |
| 2017 | 1,470 | (175,054) |

* Restated



### 3.2.3 Significant Accounting Ratios

According to the information made available, some important accounting ratios of the Corporation for the year under review and the preceding year are given below.

| Ratios | 2017 | 2016 |
|---|---|---|
| **Profitability Ratios** | | |
| Gross Profit Ratio (%) | 6.17 | 22.84 |
| Operating Profit Ratio (%) | 1.74 | 19.24 |
| Net Profit/ (Loss) Ratio (%) | 0.33 | 12.53 |
| **Liquidity Ratios** | | |
| Current Assets Ratio (Number of times) | 0.39:1 | 0.34:1 |
| Quick Assets Ratio (Number of times) | 0.27:1 | 0.24:1 |
| Working Capital (Rs. million) | (240,643) | (249,297) |
| **Investment Ratios** | | |
| Return on Assets (%) | 0.67 | 27.76 |

The following observations are made in this regard.

(a) The working capital management of the Corporation had been continuously in a negative position due to significant outstanding amount of trade and other payables (Rs.212,140.16 million in 2017) and short-term borrowings (Rs. 179,641.47 million in 2017) though out the year under review and the previous years.

(b) Further, the current assets of the Corporation is only enough to pay off 39 per cent of its current liabilities. Hence, the ability to settle the current liabilities of the Corporation is in a critical position.

## 4. Operating Review

### 4.1 Performance

#### 4.1.1 Operations and Review

The following observations are made.

(a) The Corporation had sustained the losses from following petroleum products during the year under review and previous year. Further, the Corporation had continuously sustained losses from both Petrol Octane 92 and 95 and Domestic Kerosene. Details are given below.

| Sector | Net Losses Sustained for the Year | |
| --- | --- | --- |
| | 2017 | 2016 |
| | Rs. Million | Rs. Million |
| **Transport** | | |
| Octane 92 | 16,201 | 8,251 |
| Octane 95 | 2,370 | 1,291 |
| Auto Diesel | 9,253 | - |
| **Power Generation** | | |
| Auto Diesel | 187 | - |
| **Industrial & Domestic** | | |
| Kerosene | 5,460 | 2,982 |
| Bitumen | 13.49 | - |
| **Agro** | | |
| Agro Chemicals | 121 | 90 |

(b) The profitability on Petroleum Products per litre for the year 2017 is shown below.

| Product | Selling Price | Sales Price Net of Dealer Margin | Cost of Sales | Gross Profit | Total Cost | Net Profit/ (Loss) | Total Taxes Included in the Total Cost |
| --- | --- | --- | --- | --- | --- | --- | --- |
| | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. | Rs. |
| Octane 95 | 128.00 | 123.72 | 100.84 | 22.88 | 136.99 | **(13.27)** | 60.33 |
| Octane 92 | 117.00 | 113.00 | 90.94 | 22.06 | 126.38 | **(13.39)** | 53.14 |
| Auto Diesel | 95.00 | 92.46 | 76.85 | 15.61 | 97.40 | **(4.94)** | 26.46 |
| Super Diesel | 110.00 | 106.75 | 83.42 | 23.33 | 104.24 | **2.51** | 29.01 |
| Kerosene | 49.00 | 42.85 | 63.91 | (21.06) | 70.41 | **(27.56)** | - |

**Note**

- *Total Average cost per litre includes import cost, locally refining cost, selling & distribution expense, Administrative expenses, Finance cost & exchange rate variation loss, etc...*

- *Total Tax per Litre comprises Average Custom duty, Avg. PAL, Excise Duty and Avg. NBT.*

(c) As iterated in previous audit reports, the agreement entered into between a Company in the Gas industry and the Corporation in respect of selling liquid petroleum gas had been expired on 20 October 2006. However, the Corporation is being supplied the liquid petroleum gas to that company continuously without entering into a new agreement or renewing the earlier agreement. In addition to that, the Corporation supplies liquid petroleum gas to another private company without entering into an agreement.

## 4.2 Management Activities

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### 4.2.1 Enterprise Resource Planning (ERP) System

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It was observed that there was no any agreement or a Memorandum of Understanding (MOU) between the Corporation, Ceylon Petroleum Storage Terminal Ltd (CPSTL) and Lanka Indian Oil Company (LIOC) with regard to their individual responsibilities in respect of the involvement of the Enterprise Resource Planning (ERP) System introduced by the CPSTL, and as such this system is not adequately utilized, especially for the fuel stock reviewing purposes.

### 4.2.2 Bitumen Business

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The total number of bitumen drums sold during the year under review was 74,445, and it shows 66 per cent decrease when compared with the previous year sold quantity of 217,948 drums. Furthermore, it shows a net loss of Rs. 13.49 million in 2017 against the net profit of Rs 54.39 million reported from this business in 2016. The following observations were also made at the audit sample test in this regard.

(a) A strategic marketing plan or a proper market analysis on industry as a premier entity in bitumen business in Sri Lanka was not observed and main activities of this business had not been included properly in the Action Plan of the Corporation prepared for the year 2017.

(b) Even though a Procurement Plan for the bitumen importation had been prepared, it was unable to ensure whether a market study had been conducted before preparing this Plan. As a result, significant variances were observed between the budgeted demand and actuals during the year and previous 02 years period as shown below.

| Year | Budgeted | Actual | Variance | |
|---|---|---|---|---|
| | Metric Ton | Metric Ton | Metric Ton | Percentage |
| 2015 | 114,000 | 13,793 | 100,207 | 88 |
| 2016 | 30,213 | 39,231 | 9,018 | 30 |
| 2017 | 28,474 | 13,400 | 15,074 | 53 |

(c) The Corporation had not designed and implemented an appropriate stock control system for bitumen business. Accordingly, re-order level and minimum and maximum levels of stock had not been maintained. As a result, instances were observed where non-availability of bitumen stocks for a longer period even a sufficient demand was existed.

(d) It was observed that bitumen stock had been stored in unsafely manner with open for natural damages.

(e) Although bitumen prices were determined by Marketing Division, a proper approval had not been obtained for this purpose and several instances, the prices determined by the Marketing Division were inadequate to cover even the cost.

(f) Even though price of the each type of bitumen had been fixed by issuing Circulars in time to time, discount amounting to Rs 98,032,381 had been granted during the past few years for 60/70 type of bitumen. Out of that discount, a sum of Rs 92,101,021 had been granted for private parties. However, a formal policy and procedure had not been established in this regard.

***According to the written explanation given by the present management, it was stated that discount decision was taken by then Chairman of the Corporation and therefore, they are not held responsible on it.***

(g) Approval of the Cabinet of Ministers had been granted on 19 October 2017 to the following proposals with regard to sales of 60,000 drums of existing bitumen stock in Grade 60/70 containing 180 kg of bitumen per drum.

- To sell the bitumen to the Road Development Authority (RDA) and its subsidiaries at the lowest price of bitumen purchased by the RDA.

- To provide the same price to the external bitumen buyers until the aforesaid stock lasts.

The following observations are made in this regard.

(i) The Corporation had sold 10,000 drums (1,800,000 Kg) to the RDA and 13,000 drums to a private company at a price of Rs 53.00 and Rs. 52.75 per kg respectively.

(ii) After a shorter period, the price of bitumen has been increased in the local market between Rs 66.00 to Rs 75.00. However, this price benefit had been lost to the Corporation due to absence of proper market analysis.

(iii) At an audit sample test, it was revealed that in some instances the high prices placed by the customers were rejected. For instance, a private party had ordered 500 drums at a price of Rs. 56 per kg with a bank guarantee of Rs.5,040,000. However, that order had been rejected by stating that stock is unavailable. However, thereafter, the Corporation had sold 1,150 drums to another party at Rs.53.00 per kg. Accordingly, the loss sustained to the Corporation was Rs. 270,000.

(iv) Only 10,000 drums or 17 per cent out of the total quantity had been sold to the RDA. However, more than 60 per cent of the stocks had been sold to the private parties and out of that more than 40 per cent had been purchased by two private customers.

(v) Two investigations had been conducted by the Internal Audit Division and Investigation Division of the Corporation in this regard and issued individual reports by them. According to those reports several irregularities, lack of internal controls and persons responsible for the identified losses had been highlighted. However, it was unable to ensure whether necessary actions had been taken against the persons responsible for losses and rectify the weakness and irregularities by the management of the Corporation even up to 15 October 2018.

### 4.2.3 Non - performance of the Contract

A contract was awarded to M/S. Al Masafi International General Trading, UAE (AMIGT) on 16 April 2016 for supply of 25,000 MT+/- 5% Low Sulphur Fuel Oil (LSFO) to the Corporation for the use of West Coast Power Plant (WCPP). However, the AMIGT has failed to supply the LSFO as agreed. As a result, the Corporation had to supply diesel at a cost of Rs. 95 per litre to the West Coast Power Plant instead of supplying the LSFO at a cost of Rs. 80 per litre. Accordingly, the Corporation had supplied 23,436,000 liters of diesel to the west coast power plant under the three invoices. Although the West Coast Power Plant had paid first two invoices, a problem was raised after the West Coast Power Plant refused to pay for third invoice stating that they requested to supply LSFO with lower cost as compared the higher price stated in the invoice. Hence, a loss of Rs. 73 million had to be sustained by the Corporation due to non-supply of LSFO on time. It was further observed that, a total loss of approximately Rs.322 million had been incurred to the country due to supply of Diesel (higher cost fuel) to WCPP instead of supply the Low Sulphur Fuel (Lower cost fuel). Further, the AMIGT has registered as a supplier with the Corporation without being assessed the minimum requirements requested for registration and considered the past experience with this supplier.

### 4.2.4 Collection of Monthly Utility Fee (MUF)

According to the Board Decision No. 38/1140 taken on 29 October 2013, the Board has approved to recover a Monthly Utility Fee (MUF) from all Corporation Owned Dealer Operated (CODO) Filling Stations and Treasury Owned Dealer Operated (TODO) Filling Stations with effect from 01 January 2014. However, this decision had not been implemented as expected due to various reasons. Therefore, more than Rs. 300 million per annum had been lost to the Corporation since the year 2014. Accordingly, an approximate cumulative loss of Rs. 1,200 million sustained to the Corporation since the year 2014 to 2017. Even though this matter was reiterated in previous audit reports, the actions had not been taken to charge MUF from the dealers in both categories as mentioned above.

### 4.2.5 The Common User Facility

The Shareholder Agreement and Share Sale Purchase Agreement for the above facility among Ceylon Petroleum Corporation, Lanka Indian Oil Company PLC and Ceylon Petroleum Storage Terminals Limited (CPSTL) were expired on 31 December 2008. Therefore, the pricing formula used for the purpose of determining the throughout charges and Transport income including Slab recoveries had not been revised since 2011. As a result, a provision of Rs. 655.45 million had been made by the Corporation as loan interest component throughout during the year under review though actual interest cost incurred by CPSTL was only Rs. 124.07 million.

### 4.2.6 Transport Charges

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Distribution of petroleum products and recovery of the cost thereon are done by the CPSTL through two main installations (Kolonnawa & Muthurajawela) and 12 regional stores. The following observations are made at the audit sample test carried out on transport charges paid for bowsers with a capacity of 6600 litres and issuing fuel to dealers from the installations of Muthurajawela and Kolonnawa, during the year 2017.

(a) An agreement or even a Memorandum of Understanding (MOU) for providing transport facilities and payment of charges thereof had not been entered into between the Corporation and CPSTL. As a result, the procedure and roles and responsibilities of each party could not be properly defined.

(b) The actual distances from installations i.e. Muthurajawela and Kollonnawa, to dealer locations were not properly checked by the Corporation forever. As a result, fuel had not been supplied from nearest installation (either from Kolonnawa or Muthurajawela) to the dealers. Hence, an additional transport cost of approximately Rs. 36 million had to be borne by the Corporation in 85,688 instances during the year under review

### 4.2.7 Payment of Excise Duty

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According to the information made available, the excise duty for importation of Petrol and Diesel are paid based on the quantity mentioned in the Bill of Lading or Outturn Quantity whichever is high. As per the Corporation "As required by Sri Lanka Customs this was initiate very long time back and in case of payment based on lower value there is a risk of imposing penalty on Corporation". However, accuracy of this practice was questionable to audit.

### 4.2.8 Recovery of Duties and Taxes

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An auto diesel shipment had been rejected by the Corporation in the month of January 2017 due to major deviation between the expected and actual quality. However, the Corporation had paid Rs. 1,617,202,705 as Custom Duties and taxes before discharging the cargo and it includes excise duty of Rs. 648,029,889. No fruitful action had been taken by the Corporation to recover this amount either from payments made subsequently or get refunded from customs duties over the period of 18 months.

### 4.2.9 Medical Assistant Scheme (MAS)

According to the Board Decision No. 08/1186 dated 11 August 2016, the approval was granted to separately maintain the Medical Assistant Scheme from the Thrift Society with effect from 01 July 2016 and to bear the cost for providing basic entitlement for a period of six months or until a suitable medical insurance provider is selected. However, that decision had not been implemented even as at 01 October 2018.

### 4.2.10 Pipeline Network for Oil Transportation

The following Observations are made

(a) The pipelines installed several decades back to transport of imported finished petroleum products such as petrol, diesel, kerosene and furnace oil from the Colombo Port to the Kolonnawa Petroleum Installation are in a state of repair and it was revealed that some of them have already been abandoned due to the deteriorated condition beyond repairs. Renovation and replacement of these pipelines have been a very urgent need, as a large quantity of the national requirement of the petroleum products is being carried into Kolonnawa Fuel Storage Terminal through those deteriorated pipelines. The possibility of paralyzing the whole country with a severe fuel crisis due to transporting the imported finished petroleum products through those deteriorated pipelines cannot be ruled out in audit.

(b) The Muthurajawela installation is fed through a Single Point Buoy Mooring (SPBM) facility located in the mid sea about 6 km from the shore and 7.2 km from Muthurajawela Terminal and there was no alternative supply source in case of rough sea conditions or when the SPBM facility is under maintenance. At the same time, there was no linkage between the Muthurajawela Terminal and Kolonnawa Installation for inter-terminal product transfers, which had also hampered the optimum utilization of those Terminals due to those constraints.

(c) Even though, the approval of the Cabinet of Ministers for the implementation of "Cross Country Pipeline Project" had been granted on 13 September 2012, it had not been implemented even up to 15 September 2018. The current position of the Cross Country Pipelines – Fuel Lines from Colombo Port to Kolonnawa Depot is shown below.

| Diameters of the Line (Inches) | Product | Current Position |
|---|---|---|
| 10 | Gas Oil | Working condition |
| 10 | Other White Oil | Out of Order |
| 10 | Naphtha Oil | Out of Order |
| 12 | Naphtha Oil | Out of Order |
| 14 | Fuel Oil | Working condition |

### 4.2.11 Tricomalee Tank Farm

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The Tank Farm contained of 100 Oil Tanks, each having a capacity of 12,500 cubic meters ($m^3$) (10,000 MT) and other associated facilities, had been constructed in 1930. The land with an extent of 358.553 hectares belong to the Tank Farm had been given on lease basis by the Government of Sri Lanka to the Commissioners of the Lord High Admiralty of the British Government for a period of 999 years before gaining independence to Sri Lanka. In 1961 at the request of the Government of Sri Lanka, the Corporation had paid Sterling Pounds 250,000 in three installments and taken over the possession of Land, Tank Farm, Buildings and other equipment with effect from 01 April 1964. Nevertheless, no legal documents had been obtained from the Government for the above land.

In 2003, the Government of Sri Lanka had entered into an agreement with the Lanka Indian Oil Company (LIOC) and the Corporation to lease out the storage facilities and the land to the LIOC for a period of 35 years and lease agreement should be executed within 6 months from the date of the agreement. However, the Corporation had not yet entered into any lease agreement or uses the tanks.

### 4.2.12 Stock Review Committee

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As iterated in previous audit reports, the Stock Review Committee consisted of members from the Corporation, CPSTL, JCT Oil Bank and Lanka Indian Oil Company, members of Ceylon Electricity Board (CEB) and an officer from the line Ministry and its meetings are held in every week. However, the Corporation had not maintained proper records relating to the stock levels, i.e. re-order level, maximum and minimum levels, and re-order quantity etc. in each petroleum product. The order quantity of petroleum products was decided solely based on the Stock Quantity Maintenance Report submitted by the CPSTL and no any other documents with regard to the maintenance of stocks of petroleum products had been submitted to the Stock Review Committee. However, it was revealed that, since the introduction of SAP system in 2010, the Corporation was unable to extract data to produce the reports on stock requirement.

### 4.2.13 Revaluation of Assets

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According to the Board Decision No. 04/1114 dated 16 March 2012, an approval had been granted to retain the Department of Valuation (DOV) for revaluing the lands and buildings and to complete within 03 months. Subsequently, a further approval was granted on 14 May 2012 for the payment of Rs. 5.5 million as advance for the above task. However, revaluation of lands and buildings had not been completed even up to the date of audit on 01 October 2018.

### 4.2.14 Payment of Penalty

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A sum of Rs. 57,736,913 paid to the Department of Customs to settle the amount outstanding since 2002 in respect of the bunkering operations on the basis of reimbursement that amount from the General Treasury. However, this amount had not been reimbursed even up to 30 September 2018.

### 4.2.15 Hedging Transactions

As per the audit examination carried out pertaining to the hedging transactions taken place in respect of procurement of oil during the period of 2007 to 2009, the total loss incurred to the country on those transactions as at 31 December 2017 was Rs. 14,028 million. Moreover, the Commercial Bank had filed a case at the Commercial High Court, Colombo against the Corporation by claiming US$ 8,648,300. In addition to that, a sum of Rs.3,847.1 million is shown in the books of accounts of the People Bank as receivable from the Corporation with regard to the hedging transactions.

## 4.3 Operating Inefficiencies

### 4.3.1 Sapugaskanda Oil Refinery

As iterated in previous audit reports, the existing 47 years old Refinery (commissioned in 1969) is a basic Refinery and is not able to cater the increasing demand of petroleum products in the country and this Refinery is operating with low margin when compared with refineries operating with advanced technologies including facilities to produce petroleum products at lower cost and capabilities to upgrade bottom products to high value products such as petrol and diesel, whereby maximizing the its operating efficiency. However, the CPC was unable to implement the proposed Sapugaskanda Oil Refinery Expansion and Modernization (SOREM) Project in order to ensure supplying of its products to the market in a cost-effective manner.

Even though preliminary feasibility study had been completed and the required land (35 acres) had been acquired for this purpose, as stated by the management, it was unable to initiate the project yet due to insufficient financial strength to invest for this project. Total cost of the project was estimated at US$ 2.1 billion with a payback period of less than 8 years, and the Net Present Value (NPV) of the project would be US$ 1,535 million. Further, the land acquired by incurring of Rs. 1,003 million for that purpose had been laying idled even as at 01 October 2018.

## 4.4 Transaction of Contentious Nature

### 4.4.1 Establishment of Lubricant Blending Plant in Sri Lanka

With the view to increasing the profitability of the Corporation and catering the increasing demand for Lubricants in Sri Lanka, the Corporation had entered into an agreement with Hyrax Oil SDN BHD (HOSB) to build a Lubricant Blending Plant in Sri Lanka under a Build, Operate and Transfer (BOT) basis on 06 May 2016 for a period of 20 years. Further, a separate Lease Agreement and a Supply Agreement (enable to purchase the products from HOSB) had been signed with the HOSB on the same date by the Corporation. Although the construction works of the Lubricant Plant had been completed as at 31 December 2017, the operations had not been commenced even up to 01 October 2018.

The following observations are also made in this regard.

(a) Only the proposal submitted by the Hyrax Oil SDN BHD (HOSB), Malaysia had been considered for this purpose without being followed an acceptable procurement procedure in order to select a compatible organization.

(b) As per paragraphs 2.24 and 2.25 of the Agreement, the Corporation shall obtain all necessary regulatory and Government approvals and license for importation of raw materials and blending of petroleum derivatives to be carried out at the Plant by the HOSB. However, the Corporation had not obtained the said approvals and license even up to 15 October 2018. Nevertheless, prompt actions had not been taken to implement the agreement as expected and gain the benefits from this project even up to the date of this report.

(c) It was unable to ensure whether, a proper feasibility study had been conducted before signing the Agreements by the Corporation. Even though the opinion of the Attorney General was obtained in several times with regard to the conditions in the draft agreements, a clearance from the Legal Division of the Corporation on the compliance of terms and conditions with the Attorney General's opinion had not been obtained before signing the agreements.

**4.5 Assets Management**
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The following assets had been lying idle since the acquisition of those assets.

(a) **Halgaha Kumbura Land at Wanathamulla -** This land had been acquired for Rs.10.6 million for the purpose of LP Gas Project and a Playground. However, this land had not been utilized for the intendant purpose and it had been occupied by more than 700 squatters.

(b) **Mahahena Land –** According to the correspondence made available, the Corporation had acquired this land by spending Rs. 0.625 million, and it had not been accounted for. However, this land is being utilized by the previous owner even after the acquisition in 1986.

(c) **Investments in Company Shares -** The caring value of the investments made in quoted and unquoted shares of four companies as at 31 December 2017 was Rs. 29.54 million. However, no dividend since longer period had been received to the Corporation by those companies.

**4.6 Resources Released to other Government Institutions**
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In contrary to the instructions in Public Enterprises Circulars No. PED/12 of 02 June 2003 and No. 21 of 08 January 2004 and the Letters No. CSA/PI/40 and CS/1/17/1 of 04 January 2006 and 14 May 2010 respectively issued by His Excellency the President, the Corporation had released 05 employees and 01 vehicle to other institutions in the year under review and incurred a considerable amount of money for remuneration and other allowances on behalf of these employees and payment of fuel and maintenance expenses on released vehicle.

## 4.7 Training

Even it was pointed out in my previous audit reports, the Corporation had failed to introduce a Training Policy and Guidelines for training and development activities of the Corporation even up to the date of audit on 01 October 2018. Therefore, the Corporation is following an irregular basis for the selection of officers and provides approval for both local and foreign training programs. Further, the several issues with regard to foreign training programs were brought to the notice of the Corporation by letter No.MPRD/ADM/15/02/40(com) dated 29 March 2017 issued by the Ministry of Petroleum Recourses Development (MPRD) and advised the management of the Corporation to rectify those issues immediately. However, no action had been taken by the management in this connection.

## 4.8 Market Share

The Corporation is the market leader in petroleum industry and approximately 86 per cent petroleum requirements in Sri Lanka is being supplied by the Corporation. Further, the sales volume of the Corporation had been gradually increased during the previous years.

## 5. Achievement of Sustainable Development Goals

Every public institution should act in compliance with the United National Sustainable Development Agenda for the year 2030. With respect to the year under review, the Ceylon Petroleum Corporation had been aware as to how to take measures relating to the activities under purview of its scope. The following observations are made in this regard.

(a) Although the Corporation had identified the sustainable development goals such as no poverty, good health and well-being, affordable and clean energy, and life on land etc. are related to the activities of the Corporation, the Corporation had not identified the related targets to those goals along with the milestone in respect of achieving such targets and indicators for evaluating the achievement of such targets clearly.

(b) Financial provisions required to achieve the above goals had not been included in the annual budget.

(c) Even though the existence of accurate statistical data is compulsory for evaluating the performance of certain activity, it was observed that the Corporation had not taken action to maintain an accurate data base in view of evaluating the achievement of said goals.

(d) Due to lack of coordination with other institutions, it was observed that the preparation of plans for the achieving the targeted goals had fallen into a decline, or remained weak.

## 6. Accountability and Good Governance

### 6.1 Internal Audit

Even though it was iterated by previous audit reports, the vacancies of the Internal Audit Division had not been filled even in the year under review. As per the information made available for audit, out of approved cadre of 42, 09 posts or 21 per cent were in vacant as at 31 December 2017 and out of that 08 posts or 62 per cent was in senior level. The post of Chief Internal Auditor is vacant since 10 August 2016.

### 6.2 Audit Committee

The recommendations made by the Audit Committee of the Corporation are not regularly reviewed by the Board. Instances were observed where information requested by the Committee was not completely and timely provided by the respective officials of the Corporation.

### 6.3 Procurements and Contract Process

According to the decision No.12/0295/510/003/TRB of 22 March 2012 taken by the Cabinet of Ministers, the line Ministry should make endeavor to enter into term contracts for supply of petroleum products with extended credit facilities, as opposed to the spot buying on weekly basis. However, 43 contracts (shipments) out of 89 were entered during the year 2017 on the basis of spot contract contrary to the above decision.

### 6.4 Budgetary Control

Significant variances were observed between the budgeted and the actual income and expenditure for the year under review, thus indicating that the budget had not been made use of as an effective instrument of management control.

## 7. Systems and Controls

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

| Major Areas | Observations |
|---|---|
| (i) Personnel Administration | Failure to get approval for the Scheme of Recruitments and Promotions. |
| (ii) Trade and Other Receivables | There were weaknesses in controls over the collection of dues in manner to mitigate the default risk. |
| (iii) Procurements | Non-compliance with the provisions in the National Procurement Guidelines |

| | |
|---|---|
| (iv) Utilization of Resources | Non-compliance with the Circular instructions in deploying the resources. |
| (v) Control over Information Systems | Prevailing opportunities to the officers to access and pass journal entries for previous years in the SAP system in the current year. Hence, the ability to amend other modules too in the SAP systems could not be ruled out in audit.<br><br>Further, the duplicate customers' accounts had been created in the SAP system. Hence, there is a possibility to damage the internal control mechanism of the CPC and allow misusing the credit limits, credit period and related controls over the debtors. |
| (vi) System Application Product Enterprises Resource Planning System. | (i) Allowing the third party to handle all the activities of the System without any direct involvement of the Corporation.<br><br>(ii) Failed to take action to reconcile the difference of Rs.858.9 million observed between assets control account and assets sub ledger accounts as at the end of the year under review.<br><br>(iii) Failure to introduce a written procedure for asset management activities such as, utilization and maintenance, acquisition and disposal and performing physical inventory verification, and updating the SAP ERP etc. |