Sri Lanka Export Credit Insurance Corporation – 2017

The audit of financial statements of the Sri Lanka Export Credit Insurance Corporation 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 cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 20(2) of Sri Lanka Export Credit Insurance Corporation Act, No. 15 of 1978. 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. A detailed report in terms of Section 13(7)(a) of the Finance Act had been issued to the Chairman of the Corporation on 19 July 2018.

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 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 misstatement.

As 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 risk of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Sri Lanka Export Credit Insurance 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.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

The following observations are made.

(a) Sri Lanka Financial Reporting Standard 4

In terms of Paragraph 15 of the Standard, at the end of each reporting period an insurer shall assess whether the recognized insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. Even though the total utilization of the Maximum Liability Limits issued to the exporters as at 31 December 2017 was Rs. 6,517,011,842, the provision for claims as per financial statements was Rs. 175,838,112 and the insurance liability had not been assessed according to the Standard as it was adequate.

(b) Sri Lanka Accounting Standard 16

(i) Actions had not been taken to revalue the building owned by the Corporation with a revalued amount of Rs. 95,000,000 after the year 2009 and account its fair value as per the Paragraph 34 of the Standard.

(ii) In terms of Paragraph 41 of the Standard, some of the surplus may be transferred to retained earnings as the asset is used by the entity, as such the amount of surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. However, in contrary to that an amount of Rs.8, 428,409 which was equal to annual depreciation charged based on the revalued carrying amount of the Property Plant and Equipment had been transferred from the revaluation reserve to retained earnings.

(c) Sri Lanka Accounting Standard 21

In terms of Paragraph 28 of the Standard, the exchange differences arising on translating monetary items at rates different from those at which they were translated in previous financial statements shall be recognized in profit or loss in the period in which they arise. The exchange differences as at 31 December 2017 amounting to Rs. 150,586,830 arising on translating the foreign currency denominated financial assets at the rates on the balance sheet date had been credited to an Exchange Equalization Reserve by the Corporation.

(d) Sri Lanka Accounting Standard 39

A treasury bond with a cost of Rs 295,676,664 and a face value of Rs. 310,169,000 had been discounted for Rs. 314,800,133 by the Corporation on 07 June 2017 and it was 52 per cent of total treasury bond investment. Even though the Paragraph 9 of the Standard states as “An entity shall not classify any financial asset as Held- To- Maturity, if the entity has during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amounts of Held to maturity investments before maturity”, actions had not been taken according to the Accounting Standard after discounting of that part of investment before its maturity.

2.2.2 Accounts Receivable and Payable

The debtor balances of Rs.48,265 had been receivable for more than 3 years as at 31 December 2017 from four private companies.

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

The following non-compliances with Laws, Rules, and Regulations were observed.

Reference to Laws, Rules, and Regulations, etc.	Non-compliance
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka Financial Regulation 571	Actions in terms of financial regulation had not been taken in respect of two balances totaling Rs. 336,500 included in the refundable deposit balance remained for more than 5 years.
(b) The decision of the Board of Directors No. 08/2010 dated 24 September 2010	Even though the policy fees should be charged based on the Maximum Liability Limit issued to the exporters, a sum of Rs. 22,500 had been overcharged in issuing insurance policies in respect of 3 exporters.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result for the year under review had been a deficit of Rs. 200,363,537 as compared with the surplus of Rs.156,111,575 for the preceding year, thus observing a deterioration of Rs.356,475,112 or 228 per cent in the financial result of the year under review as compared with the preceding year. Increase of expenditure for insurance claims for the year under review as compared with the preceding year by Rs.456, 165,353 or 518 per cent had mainly attributed to the above deterioration.

In analyzing the financial results of the year under review and 04 preceding years, even though the surplus of the year 2013 amounting to Rs. 163,411,762 had continuously improved to Rs. 199,076,131 by the year 2015, it had decreased gradually since the year 2016 and a deficit of Rs. 200,363,537 had occurred by the end of the year under review. However, in re-adjusting the employee remuneration, taxes paid to the Government and depreciation on non-current assets to the financial result, the contribution had been Rs. 231,115,321 in the year 2013 and then that contribution had fluctuated annually. Although the contribution had been a positive value up to the year 2016, a negative contribution of Rs.146, 050,561 had occurred during the year under review.

3.2 Analytical Financial Review

From the total premium income of Rs. 238,085,213 in the year under review, the Export Payments Insurance Policy income was Rs. 213,195,140 or 90 per cent and out of that a sum of Rs. 58,988,550 or 28 per cent had been received from one exporter. Further, 23 exporters who proving a higher contribution had contributed to a sum of Rs. 124,680,768 or 59 per cent of the Export Payments Insurance Policy income whilst a sum of Rs. 29,416,949 or 13 per cent of income had been received from 91 other exporters. Since 79 per cent of the total exporters had contributed for 13 per cent of income, it was observed that the propagation and regularization of the awareness of exporters in order to improve the productivity and existence of the Corporation is topical.

4. Operating Review

4.1 Performance

4.1.1 Planning

The following observations are made.

(a) In terms of Section 5.1 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, a Corporate Plan had not been prepared and it had been prepared only up to the year 2010 for the last time.

(b) According to the general practices, even though the Action Plan need to be prepared and approved prior to the year begins, the Action Plan for the year 2017 had been approved by the Board of Directors on 22 March 2017.

(c) According to the procurement plan prepared by the Corporation for the year 2017, the procurement relating to purchase of computer hardware and software of Rs. 19.5 million had been planned to be completed by the month of August 2017. However, the procurement works had not been completed as scheduled.

4.1.2 Performance and Review

The following observations are made.

(a) The attention had not been paid on following objectives among the stablishing objectives of the Corporation according to the Section 5 of the Sri Lanka Export Credit Insurance Corporation Act, No. 15 of 1978 during the year under review.

   (i) To provide guarantees to exporters against losses that may be sustained in undertaking market surveys, publicity and any other promotional measures in foreign countries;

   (ii) To undertake market studies abroad for promotion of exports from Sri Lanka and to conduct seminars and courses on various aspects of export promotion and to collect and disseminate information relating to marketing possibilities and procedures;

   (iii) To help exporters to diversify and expand export, find new markets and sell their goods abroad on competitive terms of payment;

(b) As per the Action Plan presented for the year under review, the activities of fixing CPA (Cost of Passenger Air fare) sign boards at 6 main Railway Stations, publishing E-newsletter quarterly, Developing a new corporate video, preparation of a claims manual on export credit insurance, preparation of a new corporate plan for 2017-2020, visits high exposure foreign buyers periodically to monitor risk profiles, Development of insurance and credit guarantee for startup export firms, preparation and finalization of organizational structure, development of job description and two activities in information technology which had allocations of Rs. 3 million and Rs. 15 million had not been implemented in the year under review.

(c) A formal procedure for the progress review in operational activities of the Corporation had not been implemented and only the financial progress had been reviewed monthly.

4.2 Management Activities

The following observations are made.

(a) In terms of section 3 of the Sri Lanka Export Credit Insurance Corporation Act, No. 15 of 1978, the Board of Directors shall consist of an officer appointed by the Monetary Board of the Central Bank of Sri Lanka. According to that, even though an officer had been appointed by the Monetary Board and that officer had not participated in any Board Meetings after the date of 28 September 2016 and the officer appointed as successor to that officer had participated only in 3 meetings in the year 2017. Accordingly, 12 board meetings had been held in the year 2017 and out of that 07 meetings had been held without an officer representing the Central Bank of Sri Lanka.

(b) Even though an officer appointed to the Board of Directors on 07 April 2015 as an officer of the Ministry of the Minister of in charge of the subject of Trade had retired from the government service on 18 December 2016, that officer had participated in 4 board meetings even after his retirement.

(c) Since the Maximum Liability Limit approved for 6 exporters was Rs. 680,000,000 and the total of the Buyers Liability Limits approved for respective exporters was Rs. 2,421,395,000, the Buyers Liability Limits had been approved exceeding the Maximum Liability Limits of exporters by Rs. 1,741,395,000.

4.3 Operating Activities

The following observations are made.

(a) The credit limits for the buyer had been approved by the Corporation without paying an adequate consideration on the recommended opinion and the credit limit approved by the Credit Report Supplying Agency in respect of the buyer, as well as the unstable economic and political situation in the Middle East countries and having obtained few information about the financial stability of the respective business enterprises in evaluating the buyer. Therefore, a claim totalling to Rs. 69,641,971 had to be paid to two exporters by the Corporation in respect of an Iranian buyer during the year 2017.

(b) In approving credit limits for an American buyer, even though the small amounts of credit with secured guarantees had been recommended according to the status report, disregarding those recommendations and the other adverse information in respect of the buyer, the credit limits had been approved by the Corporation. Accordingly the buyer had been bankrupt within a short span of time of 6 months and a claim of Rs. 13,125,826 had to be paid to the exporter by the Corporation on 21 November 2017.

(c) Since the credit limits had been approved without paying an adequate consideration on the adverse position stated in the status reports of two Russian buyers who had newly formed business enterprises with no financial statements presented, a claim totaling to Rs. 45,821,592 had to be paid to the exporters during the year under review.

(d) According to the test checks, the percentage of coverage of the approved Buyers Liability Limits by insurance policies had ranged from 60 per cent to 90 per cent. As such, it was observed that further attention should be paid on existence of the Corporation by minimizing the claim expenditure which has to be borne by the Corporation through implementing a formal procedure in approving credit limits for buyers as well as the protection of exporters.

(e) A suitable methodology had not been implement to recover the dues from the respective foreign buyers after being paid the insurance claims to the exporters as the buyer had defaulted payments relevant to the exports and to find out that the buyer had subsequently paid the exporter.

4.4 Transactions of Contentious Nature

Even though the Credit Report Supplying Agency had recommended a credit limit of Euro 130,000 equivalent to Rs. 22,000,000 with proper secured guarantees in their report on 21 August 2014 in respect of a Russian buyer relevant to an exporter, the Corporation had approved a credit limit of Rs. 60,000,000 for the buyer on 28 August 2014 and then it had been increased up to Rs. 650,000,000 or 984 per cent under the covering approval of the Board of Directors. Nevertheless, the credit limits had been approved by the Corporation disregarding the economic situations in Russia by that time and the highest amount of claim in the history amounted to Rs. 374,507,710 had to be paid to the respective exporter in the year under review. Further, the evidences on whether the attention had been paid on the liability of the Corporation in respect of the whole credit limits approved for all exporters prior to that date when enhancing that credit limit were not presented to the audit.

4.5 Staff Administration

The following observations are made.

(a) According to the letter No. DMS/E4/30/4/201/1 of Department of Management Services dated 24 September 2008, the approved cadre of the Corporation was 56 and the actual cadre as at 31 December 2017 was 37, thus existing 19 vacancies as at 31 December 2017.

(b) A Scheme of recruitments and promotions had not been introduced in terms of section 9.3 of Public Enterprises Circular No. PED/12 dated 02 June 2003 and the staff who had more than 15 years' service experience and qualifications had no opportunity for promoting for vacant posts.

(c) According to the decision of the Board of Directors, without following a formal recruitment procedure, an officer had been recruited on 02 January 2017 for a post of Management Trainee which had not been approved by the Department of Management Services and a sum of Rs. 360,900 had been paid in the year under review. Further, on 02 January 2018 that officer had been appointed for the post of Assistant Manager which had not been approved by the Department of Management Services.

(d) Even though the actions had been taken to recruit officers for the post of Marketing Executive which included in the approved cadre having called applications by newspaper advertisements, in giving appointment letters, the recruitment had been done changing the designation as Management Trainee which was not in the approved cadre instead of the post of Marketing Executive based on the decision of the Board of Directors No. 03/2017 dated 02 March 2017.

(e) The both positions of Deputy General Manager Marketing and Manager Marketing which are important for the functions and the sustainability of the Corporation had been vacant from the year 2009 to the end of the year 2017 and contrary to the Paragraph 13.2 and 13.3 of the Chapter 11 of the Establishment Code, having appointed officers for those two positions on long term acting basis and the payments amounted to Rs.270,000 and Rs. 109,200 had been made respectively as acting allowances during the year under review. It was observed in audit that existing such vacancies could be adversely affected to the functions of the marketing division of the Corporation and to the sustainability of the Corporation.

(f) There was no a post of Internal Auditor within the approved cadre and the internal audit had been performed by a private audit firm.

5. Sustainable Development

5.1 Achievement of Sustainable Development Goals

Every public institution should act in compliance with the letter No. NP/SP/SDG/17 dated 14 August 2017 issued by the Secretary to the Ministry of National Policies and Economic Affairs and the United Nations Sustainable Development Agenda for the year 2030. With respect to the year under review, the Sri Lanka Export Credit Insurance Corporation had not been aware as to how to take measures relating to the activities under purview of their scope. Therefore, actions had not been taken 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 Presentation of Financial Statements

Even though the financial statements should be submitted to the Auditor General within 60 days from the end of the financial year in terms of Paragraph 6.5.1 of the Public Enterprise Circular No. PED/12 dated 02 June 2003, the financial statements approved by the Board of Directors had been submitted to audit on 14 May 2018 and delaying the appointment of a new chairman due to the ending of the term of office of the chairman had caused for that.

6.2 Procurement

Even though a hardware firewall system had been purchased at a cost of Rs. 1,177,700 by the Corporation in the year under review, recording the Procurement Committee meeting proceedings in a standard format in terms of the guideline no. 2.11.3 of the Government Procurement Guideline 2006, providing sign declarations by the members of Procurement Committees and Technical Evaluation Committees at its first meetings according to the guideline no. 2.12 and using standard formats in bid opening had not been done.

6.3 Budgetary Control

Variations between the budgeted income and expenditure and the actuals ranging from 29 per cent to 444 per cent were observed and as such the budget had not been made use of as an effective instrument of management control.

6.4 Tabling of Annual Reports

Even though the Annual Reports should be tabled in Parliament within 150 days from the end of the financial year in terms of Paragraph 6.5.3 of the Public Enterprise Circular No. PED/12 dated 02 June 2003, there had been a long delay in tabling those reports in Parliament since the annual reports for the years 2013 to 2015 had been tabled at the end of the year 2017 and annual report for the year 2016 had not been tabled by the month of July 2018.

7. Systems and Controls

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

Area of System and Control	Observations
(a) Evaluation process of the foreign buyers	Not paying a sufficient attention in the evaluation of status reports and the determination of credit limits.

(b) Personnel Administration	Non-regularization of recruitments and promotions of employees.
(c) Operational Control	Not achieving the targets set in the action plan.
(d) Maintaining Registers	Not entering the revalued figures of the assets in fixed asset register.