

**1.1 Qualified Opinion**

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The audit of the financial statements of Kahatagaha Graphite Lanka Ltd. (“Company”) for the year ended 31 March 2019 comprising the statement of financial position as at 31 December 2019 and the statement of financial performance, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be reported to Parliament appear in this report.

In my opinion, except for the effects of the matters described in paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards for Small and Medium-sized Entities.

**1.2 Basis for Qualified Opinion**

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My opinion is qualified on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

**1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards for Small and Medium-sized Entities, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

As per Section 16 (1) of the National Audit Act No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company.

## 1.4 Scope of Audit

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My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and

whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and
- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

## **1.5 Financial Statements**

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### **1.5.1 Internal Control over the preparation of financial statements**

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Entities are required to “devise and maintain” a system of internal accounting controls sufficient to provide reasonable assurance that , transactions are executed in accordance with management’s general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards , and to maintain accountability for assets, access to assets is permitted only in accordance with management’s general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences

### **1.5.2 Noncompliance with Sri Lanka Accounting Standards**

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<b>Noncompliance with Reference to the Relevant Standard</b>	<b>Comments of the Management</b>	<b>Recommendation</b>
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Although 55 items of fixed assets amounting to Rs. 4,186,357, which had been fully depreciated owing to not reviewing the useful life of non-current assets in terms of paragraph 17.19 of the Sri Lanka Accounting Standards for Small and Medium-sized Entities, were being further utilized, action had not been taken to revise that estimated error in terms of paragraphs 10.15 – 10.18 of the Standard and to represent the accurate carrying value in the financial statements.	It is accepted that timely revaluation of fixed assets is an accounting requirement and work overload and the costs involved in that have contributed to this omission and arrangements have been made by the Management to carry out verification of assets in the future in coordination with the Valuation Department.	Action should be taken to review the useful life of non-current assets in terms of paragraph 17.19 of the Standard and to represent the accurate carrying value in financial statements.

### 1.5.3 Accounting Deficiencies

Audit Observation	Comments of the Management	Recommendation
Although the prices were not revised due to non-revision of the Service Agreement for a long time, the institution, which provides security services had submitted invoices at a higher price. Since the Company had paid the agreed value, the difference of Rs.2,721,505 prevailed between the invoice value and the amount paid had been brought to accounts as other income during the year under review. Accordingly, other income represented by the financial statements had been overstated by that amount.	In the calculation of the amounts payable to the institution, which provides security services, the payments were made according to the initial value of the Agreement and action has been taken to write off the amounts overstated at the end of the year as other income.	The security service expenditure account and the liability account payable should be adjusted by a journal entry.

### 1.6 Noncompliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules and Regulations etc.	Non-compliance	Comments of the Management	Recommendation
(a) Public Enterprises Circular No. 02/2013 dated 11 September 2013	Although an amount equal to gratuity provision amounting to Rs.17,297,407 as at 31 March 2019 should be invested, the under investment made as at that date was Rs.4,474,746.	The Company was unable to carry out this task in the same manner due to the severe shortfall of funds in the Company.	An amount equal to provision for gratuity should be invested.
(b) Paragraph 1 (ii) of the Management Services Circular No. 03/2018 dated 18 July 2018	(i) Although a daily allowance of Rs. 300 has been paid to the underground employees and the employees in the Maintenance Division and an incentive of 50 percent and 40 percent of the allowance had been	This production incentive scheme has been initiated by both the employers and employees as a collective agreement with the intervention of the Commissioner of Labour, Kurunegala and has	As per the instructions given in the Circular, the approval of the Department of Management Services should be obtained before the payment of all the

paid to the staff of the Processing Division and the Office respectively when the minimum production is 65 MT, the approval of the Department of Management Services had not been obtained. been submitted to the Board of Directors and action is being taken to prepare a more effective production incentive scheme and to get the approval for that scheme. allowances.

- (ii) A premium of Rs.872,736 was paid without getting approval during the year under review for a group medical insurance scheme, which covers all the employees. The Group Medical Insurance Scheme has been used to cover medical expenses of employees and it is the Agrahara Insurance Scheme of the Government. It is expected to cover the medical expenses of the employees who frequently suffer from illnesses (respiratory diseases) due to graphite related work. The approval of the Department of Management Services should be obtained as per the instructions given in the Circular.

- c) Letter of the Department of Management Services bearing No. DMS/11P/C9 dated 04 October 2007
- (i) It had been stated that 79 officers approved for the Company should be recruited subject to a contract period of 06 months and extension of the contract period should be considered on the profitability. Even though the Circular No. 25/2014 issued by the Ministry of Public Administration and Home Affairs dated 12 November 2014 was not applicable to companies, 59 employees of the Company had been confirmed in the service as per that Circular.
- Action has not been taken to get the schemes of recruitment of the staff approved and it has been done as per the Circular No.25/214 dated 12/11/2014 issued by the Ministry of Public Administration and Home Affairs and as per the instructions of the Secretary of the Ministry of Industry subject to the approval of the Board of Directors. Arrangements have been made to confirm a part of the employees in the service and the Department of Management has informed that this error should be rectified.
- Action should be taken in accordance with the letter of the Department of Management Services and only the relevant Circulars should be made applicable.
- (i) The Scheme of Recruitment for the contractual staff had not been approved and even though there had been no permanent staff approved by the Department of Management Services for the Company even by the end of the year under review, the actual staff of the Company was 195.
- As the approved staff has not been revised for a long time, action has been taken to recruit various employees from time to time subject to the approval of the Board of Directors to carry out the essential functions.
- Taking action to approve the scheme of recruitment for the contractual staff and to act in compliance with the letter of the Department of Management Services.

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| (d) | Section 03 of the Public Finance Circular No. 02/2015 dated 10 July 2015          | Action had not been taken in terms of the Circular to dispose of the jeep of the Company worth Rs. 613,000, which has been idling since 2006.   | The vehicle is now completely depreciated and the Management has already decided to dispose of this idling vehicle by following the government tender procedure. | Action should be taken to dispose of the vehicle as per the Circulars. |
| (e) | Section 2 (1) of the Asset Management Circular No. 02/2017 dated 21 December 2017 | Even though nearly five years have passed since the Nissan van was handed over to the Company in 2015 by the Ministry of Industry and Commerce, action has not been taken to take over the vehicle. | The Management has decided to act in accordance with the Asset Management Circular in the future.  | Action must be taken to transfer the vehicle.                          |

## 2. **Financial Review**

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### 2.1 **Financial Result**

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The operating result for the year under review was a loss of Rs. 1,600,289 and the corresponding loss for the previous year was Rs. 2,845,938. Accordingly, an improvement of Rs. 1,245,649 was observed in the financial result. This improvement was mainly due to the reduction in other expenses.

### 2.2 **Ratio Analysis**

	<b>2018/19</b>	<b>2017/18</b>
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Current Ratio	7 : 1	9 : 1
Quick Ratio	0.6 : 1	1.26 : 1

An deterioration in the current asset ratio and the quick asset ratio was observed as compared with the preceding year and liquidity of the Company was weak according to the quick asset ratio and the stock had been 92 percent out of the total current assets.

### 3. Operational Review

#### 3.1 Management Inefficiencies

Audit Observation	Comment of the Management	Recommendation
(a) Although strategies need to be formulated to increase the production capacity by identifying production targets for each year and planning monthly production accordingly and measuring the progress, the average monthly production in the last 03 years was 65 MT and it was not possible to improve the average monthly production even during the year under review.	It was verbally agreed to produce at least 65 MT of graphite per month and to pay a production incentive of Rs.300/- per person per day. Accordingly, the employees had not taken action to increase the production as per the Agreement. However, steps have been taken to overcome this problem by hiring new employees and obtaining the service of an experienced Mining Engineer and formulating and controlling future planning activities.	Action should be taken to increase the production capacity by identifying the production targets for each year and by planning the monthly production accordingly.
(b) Although 12% of production has been identified as average waste, it was not observed by the audit as a systematically identified percentage.	The average waste identification percentage in the manufacturing process, which is 12 percent, needs to be revised periodically and steps have been taken to add refined graphite production to the stock as a permanent solution to this.	The average waste percentage should be identified systematically.
(c) It was observed that there had been an inefficient operational process in the Company as it takes a long time to sell the manufactured stock with a frequency of stock turnover of 0.6 and an stock holding period of 608 days.	We are currently dealing with two traditional buyers and the prevailing low demand has led to the assembly of graphite stocks. The Management has taken action to invite international tenders with the coordination of the Ministry of Industry for the sale of these graphite deposits and accordingly, a reduction in the stock holding period is expected in the future.	An efficient operating process should be achieved by the Company by increasing the frequency of stock turnover and by reducing the stock holding period.



- (d) Action had been taken to verify the accuracy of the value of Rs. 5,559,581 stated in the accounts as goods and services tax to be charged and to charge that amount or to offset that amount for the taxes payable.
- The value added tax value amounting to Rs.5,559,581.00, stated in our accounts as at 31 March 2019 is the balance according to our accounts and it has been requested by the Inland Revenue Department through monthly tax returns. Only verified payments can be offset for taxes payable and action is being taken to indicate the VAT tax claims that are rejected during the audit process in accounts. The Inland Revenue Department has not yet commenced tax audit after the year 2017 and this balance has to be reported in the accounts.
- Action should be taken to recover taxes or to offset for the taxes payable.