

Milco Private Limited - 2018

The Audit of operations of the Milco private Limited for the year ended 31 December 2018 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 report to Parliament in accordance with Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka

1.2 Responsibility of the management and the controlling parties in regard of presenting the financial statement

All the entities which are audited should maintain books and reports about their income, expenses, assets and liabilities in an appropriate way that enables to prepare the annual and timely financial statements of that entity in terms of Section 16 (1) of National Audit Act, No. 19, 2018. According to Section 16 (2) of the Act, annual financial statements related to all the audited entities and annual performance reports which can be presented according to regulations within a specific time period should be handed over by chief accounting officer to the Auditor General. It should be certified that the annual reports and other financial statements have to be prepared within the necessary times, in terms of Section 38 (1) (D). Furthermore, chief accounting officer should be accountable to present related reports of audited entity to the Parliament.

1.3 Presenting Financial Reports

Even though financial statement and draft annual report should be presented within 60 days after ending the financial year to Auditor General in terms of Section 6.5.1of the Public Enterprises Circular No. PED/12, dated 02nd June 2003, financial statements and draft annual report of the year 2018 had not been presented to Auditor General even up to the date of 11th March 2020.

2. Financial Review

2.1 Financial Results

When analyzing the financial result of last five years before applying the depreciation of non-current assets, salaries and wages of main office and the tax, the contribution of the company from 2012 to 2017 had decreased from Rs. 629 million to Rs. 212 million.

2.2 Ratio Analysis

The gearing ratio of the company had increased from 0.64 to 9.8 during the period of 2012 to 2017 due to the loans obtained for the factory renovation project and Badalgama project.

3. Operating Review

3.1 Identified Loss

Audit Observation	Comments of the Management	Recommendation
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(a) After establishing the new DESMI machinery in Ambewela factory, the thick waste of milk had been increased. At the end of the production cycle at the old plant, the milk that is removed during the cleaning process is stored in a tank and added back to production. But there was not a technique to collect those milk to the production again when cleaning the new DESMI machinery after ending a production round and around 1080ml of milk value amounted to Rs. 74,206 had been wasted. It was observed that necessary steps had not been taken to reduce the increment of that waste with engineers of DESMI project or any other responsible parties within the relevant responsible time period.	There were not facts to be disagreed. (This situation had been occurred due to the reasons out of management control.)	Responsible parties should take actions to reduce the increment of new DESMI machinery waste.
(b) A cost estimate, value amounted to Rs. 1,020,000 to prepare a new pipe system for new machinery to collect the remaining milk again into the production had been presented by an executive engineer on 17 th September 2018. Even though that estimated cost can be covered within 46 days by preventing that waste, a feasibility study about that proposal had not been done and necessary actions had not been taken to reduce the waste of factory though it had been one year and five months after starting the production of new machinery by 31 st December 2018.	There were not facts to be disagreed. (This situation had been occurred due to the reasons out of management control.)	Responsible parties should act upon doing a feasibility study on the proposed action and reduce the waste of factory by collecting the reaming milk into the production again.

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| <p>(c) When the boiler which was used for the production of new machinery was inactive and then cleaning it, around 1080ml of milk value amounted to Rs. 74,206 had been removed at one time and within the considered two month sample time period of October and November 2018, boiler had been inactivated 18 times. According to that within two months 18,000ml of milk value amounted to Rs. 1,237,050 had become a waste when cleaning the boiler again and it is a huge loss annually and actions had not been taken to prevent this abnormal inactivation until 31st December 2019.</p> | <p>There were not facts to be disagreed. (This situation had been occurred due to the reasons out of management control.)</p> | <p>Responsible parties should take actions to reduce the abnormal inactivation of boiler and the waste of milk.</p> |
| <p>(d) Even though the production of milk powder 771,652 kg after 2017 of July was flawless according to the laboratory reports after establishing the new machinery under the factory renovation project, the issued milk powder value amounted to Rs. 475.2 million, 720,000 kg in the month of August 2017 had been brought back to the store because of receiving complaints from consumers stating they are inappropriate for human consumption and after selling them for animal food in 2018 and 2019 remaining 666,075 kg was still stored in Ambewela factory even up to the date of 31st December 2019.</p> | <p>There were not facts to be disagreed.</p> | <p>Milk powder should be issued into market only after a complete test of suitability for human consumption.</p> |

3.2 Management Inefficiencies

Audit Observation	Comments of the Management	Recommendation
<p>(a) When investigating the stock survey from 26th of December to 30th Of December 2018, it was observed that the risk of expiring the stock was high</p>	<p>There were not facts to be disagreed.</p>	<p>Stock controlling should be done appropriately without expiring stock and</p>

because of not storing the stock according to the First In First Out method. Furthermore, the attention was not paid for keeping excess goods in stock and destruction. Even though there were stock ledger cards to mention the maximum stock level, minimum stock level and re order level, an actions had not been taken to mention the quantities on it. Further observations had been mentioned below.

destruction of stock.

(b) Digana Milk Factory

(i) Stock of product packaging which was received during 2013 to 2017 and value amounted to Rs. 11,045,003 was in an unusable condition by the stock survey date of 31st December 2018 and that stock had not been mentioned as the damaged stock in the stock evaluation reports on 31st December 2018.

There were not facts to be disagreed.

Unusable stock should be reported properly in stock evaluation reports and accurate stock condition should be reported through accounts.

(ii) During the audit it was observed that 137 unusable machinery spare parts value amounted to Rs. 326,940, 13 vehicle spare parts value amounted to Rs. 350,992 and 75 vehicle and machinery spare parts which the value could not be identified were in the store.

There were not facts to be disagreed.

An assets verification should be done regarding the unusable parts and act according to the recommendations of assets verification board.

(c) **Observations on engineering store at Ambewela factory**

(i) On the sample examination of at engineering store, 67 parts belongs to 43 items value amounted to Rs. 7,443,498 as at 31st of December 2018 were inactive ranging from 2 years to 25 years in the store and there was no attention given on the ability of using those equipment

There were not facts to be disagreed. inventory

Necessary actions should be taken to use relevant equipment or dispose.

for other factories of the Company.

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| (ii) | At the annual stock counting of year 2014, 2041 stock items value amounted to Rs. 6,041,166 were decided as unusable but they were still at the store of production section as defective material at the stock auditing date, 18 th December 2018. | There were not facts to be disagreed. | Necessary actions should be taken to dispose those items. |
| (iii) | Even though an adequate internal control should be maintained enabling that separate good receive notes are issued for each task on the approval of a responsible officer when issuing material from engineering store, it had not been done. | There were not facts to be disagreed. | When issuing material an adequate internal control should be maintained. |
| (iv) | | | |
| (v) | After the installation of the new factory under the factory modernization project, all the spare parts provided for future use had been stock piled without any sorting and the material had not been included in an inventory or any other documentation. | There were not facts to be disagreed. | Material should be reported in an inventory document. |
| (vi) | | | |
| (d) | Packaging and finished goods store at the Ambewela factory. | | |
| (i) | Even though the total amount of 1858 kg of polythene packing material had been used in the year 2018 for non-fat milk powder packing, the inventory for the last purchased date, 13 th of August 2018 was 21,459 kg. According to that there was an excess inventory of 17,454.88 kg value amounted to Rs. 10,413,024 as at 31 st December 2018. | There were not facts to be disagreed. | Company should establish accurate inventory levels and maintain them efficiently and economically. |

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| (ii) | Unused 17,750 kg of milk powder packaging (metalized polyandry) value amounted to Rs. 15,699,277 and 31,000 of fertilizer bags before the year 2016, had not been identified as obsolete stock as at 31 st of December 2018 in Ambewela factory. | There were not facts to be disagreed. | Stock survey should be done properly and reported properly after identifying the obsolete stock. |
| (e) | At Ambewela factory, ghee was produced by using butter as the material and the ability of ghee production was 24,427 kg by using the 30,000 kg of butter which was expired on 31 st December 2018. According to that regard of this stock, value amounted to Rs. 23,796,840 of loss had to be bearded and it had not been identified as stock damage and loss until 31 st of December 2018. | There were not facts to be disagreed. | Stock damage and loss should be identified and reported in accounts properly. |
| (f) | When comparing balances of stock books at the stock verification of general store in Ambewela factory, there was a deficiency of 3 items value amounted to Rs. 601,847 and an excess of 5 items value amounted to Rs. 46,752,278 and it was observed in the audit that this store was maintained insecurely without an internal control and there were not techniques to examine through responsible officer about including the stock which are received from production section and issues from the store in ledger books properly. | There were not facts to be disagreed. | Issuing stock should be included properly in the ledger books and they should be examined through a responsible officer. |
| (g) | Even though the butter packaging machine of Ambewela factory had been handed over to a private institute in Colombo for the repair on October 2018, that machine had not been | There were not facts to be disagreed. | Officers should take actions to repair factory machineries according to an agreement and bring them back in due |

repaired and handed over again by the audited date of 26th December 2018. According to that it was observed there was a 12,225 kg of butter stock without packing as at 31st December of 2018 due to this production had been stopped 3 month of period.

time periods.

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| (h) | It was observed that using plastic packaging costing Rs. 9.12 instead of using aluminum packaging costing Rs. 8.42 for 200g butter packaging units was disadvantageous for the Company due to the delay of repairing above machine. | There were not facts to be disagreed. | Ways of butter packing should be chosen advantageously for the Company |
| (i) | At the Ambewela factory, the seventh floor of new machinery contains the dryer which convert milk into powder and it had top mounted four nozzles which were removed to clean after the production and until those nozzles were fixed in the next day to start the production and it was observed that because of not closing the aperture of the dryer had a risk of collecting things for the production which are inappropriate for the human consumption. | There were not facts to be disagreed. | Make sure the products are safe for health. |
| (j) | Even though there were two or more employees were always employed in new machinery, there was not a door to exit in an emergency in any of the seven floors. Furthermore, extinguishing cylinders which were used for emergency firefighting, throughout the Ambewela premises had expired and any reconditioning had not been done on them | There were not facts to be disagreed. | Actions should be taken for the security of employees who were employed at the building and for the established machineries from fire damages and other emergencies. |
| (k) | It was observed that there was not enough and suitable sanitary facilities for 234 employees who were employed at the Ambewela factory | There were not facts to be disagreed. | Actions should be taken to give enough and suitable sanitary facilities to the |

which spreads throughout 4 acres and consisting of 4 four buildings as at 31st of December 2019.

employee at factory.

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| (l) | Stock books had not been maintained for Ambewela milk factory and Digana milk factory. | Document was not maintained because of having a large amount of items at the factory and for that bin cards were used. Updating the bin cards were done using the GRN and MRN cards. | Actions should be taken to maintain inventory books for internal investigation and control of the factory. |
| (m) | A register of electricity fixings and equipment had not been maintained for the Digana milk factory. | Actions are to be taken to maintain proper documents in future. | A register should be maintained regarding electricity fixings and equipment. |
| (n) | Some officers who should keep a bond had not kept a bond and register of bond also had not been maintained. | Only shroffs keep bond deposits now and actions are to be taken to keep bond deposits according to the guidance of control unit of main office in future. | Actions should be taken to keep bonds. |
| (o) | A register of fixed assets had not been maintained. | A proper register is to be maintained regarding all the fixed assets in future. | Actions should be taken to manage assets. |
| (p) | A register of fixed assets regarding computer hardware and software had not been prepared. | A brief computerized document regarding fixed assets of factory had been updated and a proper register is to be maintained on all the fixed assets in the future. | A register of fixed assets should be maintained on computer hardware and software. |

3.3 Operational Inefficiencies

Audit Observation	Comments of the Management	Recommendation
<p>(a) Even though since June 2017 to March 2018, it had earned a total of Rs. 124,885,082 by producing 250ml milk bottles and Rs.15,082,405 by producing 500ml milk bottles before the machine became inactive which produce vanilla and chocolate milk drinks at the Digana milk factory, the income which was to be obtained for the company was lost because of the inactivity of the machine for 1 year and 2 months since March 2018 to 3rd of May 2019.</p>	<p style="text-align: center;">-</p> <p>It was a delay of supplier.</p>	<p>Actions should be taken to maintain the repairs and maintenance of the factory machineries properly and while obtaining the income which is to be received for the company.</p>
<p>(b) The performance reports had not been presented to the Department of Public Enterprises, the relevant Ministry and the Auditor General after being prepared them quarterly, semi-annually and annually according to the section 4.2.3 and 4.2.6 of the Public Enterprises Circular, No. 12, dated 02nd of June 2003.</p>	<p>It was informed at the meeting of audit & Management of ministry that preparing performance reports separately is not needed as reports are prepared by the company annually.</p>	<p>It should be acted according to the provisions of the Public Enterprise Circular.</p>
<p>(c) Below factors had been observed according to the performance report which was presented to the annual report of ministry by the company for the year 2018.</p>		

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| (i) Even though it was planned to collect 119.94 million liters of milk according to the action plan for the year 2018, actually collected milk was only 91.10 million liters and it was 76 percent from the expected amount. It was observed that comparatively 5.11 million liters were low in the year of 2018 than the amount 96.20 million liters which had been collected in the year, 2017. | The production of milk had been reduced in many areas of the island because of the adverse effect of the political situation, and there was an effect from delaying the payments for dairy farmers due to financial difficulties. | Action plan should be updated according to the prevailing internal and external factors. |
| (ii) When examining the progress of projects which were planned by the action plan, It was observed that relevant to the activities of starting new autonomous dairy farmer's association was 37 percent, starting farms with 200 liter capacity of daily milk was 41 percent, conducting one-day trainee programs for the officers of autonomous association was 41 percent and comparatively actual acquired amount is lower than the 50 percent to the goals in the year under review. | Development programs were unable to meet as expected because of the prevailing financial situation. | Action plan should be updated according to the prevailing internal and external factors. |
| (d) When examining the progress of milk productions of the company, even though pasteurized milk production had been increased by 19 percent in the year 2018 when compared to the year 2017, it is seen that it had been decreased by 24 percent when compared with the year 2016. Furthermore cheese production had been increased by 21 percent when compared to the year 2017 and it had been decreased by 14 percent when compared to the year 2016, with the year under review. Yogurt production and milk powder production had been decreased by 0.4 percent and 9 percent respectively in the year under review compared to the year 2017. | - | Management should take actions to achieve expected production progress. |

3.4 Inactive or underutilized property plant and equipment.

Audit Observation	Comments of the Management	Recommendation
(a) After calling the tenders on 27 th of June 2011 and according to the agreement with a private institute under the approval of director board on 31 of January 2012, the main office had purchased an ice cream machine value amounted to Rs. 12,470,778 (\$94,500) and fixing value amounted to Rs. 214,700 which agreed to finish the fixing by 09 th of May 2013. Later, that machine had been handed over to Digana factory in April, 2014 and it had not been used until the audited date of 24 th of December 2018.	There were not facts to be disagreed. (This situation had been occurred due to the reasons out of management control.)	Management should be accountable to purchase only after identifying the requirement properly and to utilize those assets.
(b) The old butter production machine which produce 3000g of butter daily had removed from the production after receiving the new machine and it was observed that it was not used for one and half years as at the audited date of 18 th November, 2018.	There were not facts to be disagreed. (This situation had been occurred due to the reasons out of management control.)	Management should take actions to find out the ability of reusing the old machine or dispose it.
(c) A Register had not been maintained regarding the damaged and lost assets.	A separate document is not maintained regarding the damaged and lost assets.	Necessary adjustments should be done by identifying the loses of damaged and lost assets.
(d) Annual asset verification had not been done and also asset verification had not been done when new circuit bungalow keeper comes or former circuit bungalow keeper resigned from the service.	Actions had been taken to hand over all the assets in written for an assistant employee after evaluating the performance on the duty.	Actions should be taken to do an annual asset verification for internal investigation, control and to present accurate information through accounts.
(e) Inventory levels had not been decided by the management.	Agreed with the audit observation. Factory store facilities are limited and store facilities are to be broaden in future.	Management should decide the inventory levels to prevent from excess stock and stock damages.

3.5 Commencing projects on the lands and properties which are not formally acquired

Audit Observation

The land where the Ambewela factory was located had been measured on 10th of March 1980 and belongs to the plan No. 4754 which has 40 acres, 01 rood and 36 perches and yet actions had not been taken to acquire this land's ownership to the company so far even though there are company owned construction and fixings value amounted to Rs. 5,548 million.

Comments of the Management

Fifty years of tax right for the lands had been given by the decision of cabinet of ministers on 07th March 1998.

Recommendation

Actions should be taken to acquire the lands' ownership.

3.6 Procurement Management

Audit Observation

Even though company had allocated Rs. 564 million and Rs. 217 million for purchasing capital assets and repairing capital assets respectively in the year under review, a procurement plan had not been prepared according to the Section 4.2 of Government Procurement Guideline, 2006.

Comments of the Management

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Recommendation

Procurement plans should be prepared according to the Government Procurement Guideline.

3.7 Human Resource Management

Audit Observation

- (a) The security service of the Ambewela factory had been obtained from a private institute and company pays them according to a signing report which submitted by that security division so their arrival and departure had not been supervised by the management of the factory. According to that actions had not been taken to create an adequate internal control by recording the arrival and departure of security officers through a fingerprint machine.

Comments of the Management

There were not facts to be disagreed.

Recommendation

Actions should be taken to maintain the internal control properly.

- (b) According to the investigation of overtime payment on April 2018, regarding a selected sample of 22 employees relevant to the Narahenpita factory of the Milko Company, it was observed that monthly over payment was Rs. 383,237 because of paying overtime more than the actual time that those employees worked.
- According the audit When making a observation, virtual payment, the overtime payment had recommendation and been done as per the approval for the method of providing voucher should be transport facilities to given after proper employees who were inspection and in employed at night and accordance with the letting to rest and start relevant circular work again in the provisions. morning for the employees who worked till passed the mid night.

3.8 Control of Vehicle

Audit Observation -----	Comments of the Management -----	Recommendation -----
(a) Even though log books should be maintained for each vehicle in the company, log books had not been maintained regarding to the 10 vehicles in the Digana milk factory.	Advises had been given to the management (transportation) to be provided and maintain log books in future.	Log books should be maintained to manage vehicles properly.
(b) Even though a list of motor vehicles should be maintained by the officer in charge of the vehicles about the details of motor vehicles which he is in charge and other appropriate details, a list of such vehicles had not been maintained in the Digana milk factory.	The detailed reports about all the vehicles of the company were maintained by the transportation division of main office and a list of motor vehicles is not in the Digana factory. Actions is to be taken to give a copy of motor vehicle list for each factory in future.	The officer in charge of vehicles in each factory should maintain the details about the vehicles which he is in charge.

4. Accountability and Good Governance

Audit Observation -----	Comments of the Management -----	Recommendation -----
(a) Markets that company currently owns, details of suppliers and organizational	Organizational structure had not been	Plans should be prepared including

structure was not included in the business plan of 2018-2020 as per the Section 5.1.2, of the Public Finance Circular, No.01/2014, dated 11th February 2014 and the Public Enterprise Circular, No.12, dated 02nd June 2003.

included in the complete details of the business plan and it is according to the Public Enterprise Circular. to be included when preparing the business plans in future.

- (b) The action plan prepared in accordance with paragraph 5 (2) of the Public Finance Circular No. 01/2014 dated 11 February 2014 should include the Budget Financial Statement, Cash Flow Statement, Human Resource Development Plan, Debt Repayment Plan, Internal Audit Plans, Organizational structure of the updated organization, approved staff and existing staff were not included.
- Cash flow statement, human resource development plan, debt repaying plan, updated organizational structure, approved staff and the details of the existing staff had been separately prepared.
- Action plan should be prepared according to the provisions of circular.
- (c) Even though the company had computerized an inventory management software which had been established and activated in January 2018 at engineering storage division, there was not any facilities to examine the receipts and issues prior to that day in the balance of the inventory and inventory measurement units (eg: liters, kilograms, meters) also had not been included. Furthermore, 103 inventory items had been taken a negative value for that day. Due to that the accuracy of the balance of inventory which gives through that software was in an unacceptable manner and actions had not been taken to identify and correct those weak points until 31st of December 2018.
- There were not facts to be disagreed.
- Actions should be taken to update the weak points in the computer software.
- (d) Although the budget approved by the Board of Directors should be prepared 15 days prior to the commencement of the financial year in accordance with Section 5.2.5 of the Public Enterprises Circular on Good Governance, June 2003 and submitted to the Ministry of Line, the Department of Public Enterprise, the
- There were not facts to be disagreed.
- According to the Public Enterprise Circular, actions should be taken to prepare and approve the budget on due date and control the funds properly.

Treasury and the Auditor General. The Capital Budget for the year 2018 was approved by the Board of Directors on 12 March 2018 and the Recurring Budget on 02 May 2018 and submitted for audit on 19 September 2019.

- (e) The sum of Rs. 392.48 million of purchases and repairs in the capital budget which had been prepared by the company was not included in the action plan.
- Actions plans could not be prepared for all the expenditure codes. Action plans are prepared only for development activities and planned machinery/ building renovations (large scale)
- Expenditure codes which were included in the capital budget should be included in the action plan.