Northsea Limited -2019/2020

1.1 Disclaimer of Opinion

The audit of the financial statements of the Northsea Limited ("Company") for the year ended 31 March 2020 comprising the statement of financial position as at 31 March 2020 and the statement of comprehensive income, 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.

I do not express an opinion on the accompanying financial statements of the Company. Because of the significance of the matters discussed in the Basis for Disclaimer of Opinion section of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.2 Basis for Disclaimer of Opinion

I do not express an opinion based on the matters described in paragraph 1.5 of this report.

As described in paragraph 1.5, I was unable to confirm or verify by alternative means, material items included in the statement of financial position, statement of comprehensive income, statement of changes in equity and cash flows.

As a result of these matters, I was unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded amounts and the elements making up the statement of financial position, statement of comprehensive income, statement of changes in equity and cash flows.

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

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, 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 Auditor's Responsibility for the Audit of the Financial Statements

My responsibility is to conduct an audit of the Company's financial statements in accordance with Sri Lanka Auditing Standards and to issue an auditor's report. However because of the matters described in the basis for Disclaimer of Opinion section, I was not able to obtain sufficient appropriate audit evidences to provide a basis for an audit opinion on these financial statements.

1.5 Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(i) As per paragraph 69 of Sri Lanka Accounting Standard (LKAS) 01, liabilities to be settled during next twelve months to be shown under current liability. Contrary to that, the Company had shown the trade creditors amounting to Rs. 64,177,709 under noncurrent liabilities in the financial position statement.	The Trade Creditors are non-current liabilities as the Company is not in a position to settle it within one year, with the exception of J.P. Fernando and Arleen (Pvt) Ltd, which are our regular suppliers of raw materials and the balances due to them are settled on a revolving basis.	As per the standard trade creditors should be shown under current liabilities.
(ii) As per paragraph 16 of Sri Lanka Accounting Standard (LKAS) 07, cash payment made to acquire long term assets should be shown as cash flows from investing activities. Contrary to that, assets purchased during the year under review, amounting to Rs. 545,526 had not been shown in the statement of cash flow.	The cash flow statement only considers Fixed assets which provide a return as an Investing activity. As a result, only the purchase of machinery was treated as an investing activity and not any other items, as they do not provide a return.	In the financial statement Company stated that LKAS are followed. Therefore, as LKAS 07 All the fixed Assets purchased should be included under investing activities in the cash flow statements.

(iii) As per section 10 of the Sri Lanka Accounting Standard (LKAS) 37, any possible obligation arises from past events should be disclosed in the financial statements. Contrary to that, even though an ex-employee filed a case demanding compensation, this had not been disclosed as contingent liability in the financial statements despite the Company deposited Rs. 615,360 in the court relevant to this case.	The Company has only followed the court order and made a deposit of Rs. 615,360 which could be refunded, if our appeal against the case is successful. Therefore, it cannot be considered a contingent liability as the case is ongoing and within the control of the Company. The ex. employee's services were terminated due to his violation of the code of conduct of the Company.	In the financial statement Company stated that LKAS are followed. Accordingly, possible contingent liabilities should be identified and disclosed or provided as the nature of certainty of the contingent liability.
(iv) As per paragraph 51 of the Accounting Standard (LKAS) 16, useful life of asset shall be reviewed every year and change in expectation shall be accounted for as a change in an accounting estimate in accordance with LKAS 8. Contrary to that assets at a cost of Rs.3,549,372 were fully depreciated at the time of preparing financial statements and still used by the Company had not been complied with the standard.	We will take the necessary steps to rectify it.	Management should take necessary action to rectify the matter.
(v) As per Sri Lanka Accounting Standard (LKAS) 20, grants related to assets including non- monetary grants, at fair value shall be presented in the statement of financial position either by setting up the grants as differed income or by deducting amount of the asset. Contrary to that company had amortized total the government grants related to assets which were expended for purchasing assets amounting to Rs.103,500,000 in 2018/ 2019 and Rs. 99,968,373 in 2016/2017 without considering useful life related to assets and the error had not been rectified up to reporting date. Hence accumulated loss as at 01 April 2019 was understated.	The Government Grant was classified as Equity from the Financial year 2015/16 up to the financial year 2019/20, since it is not repayable and hence, it is not practical to treat it as a differed income under non-current liability, as we have already utilized the Grant. Also, the Auditors have approved of the treatment of Grant in the Financial years 2015/16, 2016, 17, 2017/18 and 2018/19 and the international standards allow the Grant to be treated as Capital Reserves. However, the classification of Government Grant was questioned at the Annual General Meeting by the	In the financial statement Company has stated that LKAS are followed. Accordingly, government grants should be accounted as the requirement stated in LKAS 20.

	Treasury representatives and we were asked to comply with the LKAS 20 and treat it as a Differed Income and classify it as a non-current liability. It was agreed that the classification of Government Grant will be rectified and the Grant will be classified as s Differed Income under non-current liability with effect from the Financial Year 2020/21.	

1.5.2 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
(i) Rent paid in advance of Rs. 200,000 for April 2020 for Head office premises had been shown as expense in the income statement, instead of showing as advance payment under current assets. Hence, the net loss of the year had been overstated and current assets had been understated by the same amount.	The Rent advance will be duly accounted in the current year.	Only the rent expenses pertain to the financial year should be included to the statement of comprehensive income and extra payments should be considered as advances or prepayment.
ii) Due to inaccurate identification of recurrent expense of Rs. 465,300 as capital expense, the net loss for the year under review had been understated and the noncurrent assets were over stated by same amount.	The expenses were capitalized as they are one off expenditure and add value to the corresponding assets and are not recurrent expenditure.	Management should take action to classify the expenditure accurately by nature and accounted accordingly.
(iii) Interest expense related to the period from 2018 to July 2020 amounting to Rs.14,420,368 arisen due to obtaining LC loan from state bank in 2018, had been shown as expenses in the current period, hence, net loss for the year and current liabilities had been overstated.	The Bank of Ceylon did not provide us with the exact breakdown of the import loan interest details year wise and the import loan interest pertaining to the year 2018/19 was not stated in the corresponding financial statements for the year 2018/19. Hence, the entire interest at the date the accounts was closed in July 2020 was reflected in the financial statements for the year 2019/20, since the closing of accounts was delayed due to the	Management should identify expenses relevant to particular period and prepare the financial statement to avoid over or understatement of profit/loss and assets/liabilities.

	closure of the Company from March 16th to May 11th owing to the Covid 19 pandemic. The situation will be rectified in the current year 2020/21 and the import loan interest will be charged accordingly.	

1.5.3 Going Concern of the Organization

Audit Issue	Management Comment	Recommendation
As per paragraph 25 of the Sri Lanka Accounting Standard No.01, when preparing financial statements, management should make an assessment of entity's ability to continue as going concern and disclose any material uncertainties. Contrary to that even though the material uncertainties prevail at the time of preparing financial statement, disclosure had not been made as notes in the same.	Northsea Ltd is a 100 percent Treasury Owned Company and has been facing uncertainties from the inception. We have specified our problems in the Corporate Plan and we are trying overcoming it.	Management must consider the uncertainties at the time of preparing financial statement to complied with the standards and indicate real situation of the Company to users of financial statements.

1.5.4 Documentary Evidences not made available for Audit

Audit evidence for following balances was not made available for audit.

Item	Amount Rs.	Evidence Not available	Management Comment	Recommendation
Accounts Receivables	15,001,943	Debtor Confirmation	We have made available the relevant documents to substantiate the balances and confirmation to the Audit. Hence, it is wrong to state that the confirmation is not available. Further, we are unable to obtain confirmation from the foreign creditor M/S. Chidamparam Pvt Ltd and the Age old Creditors outstanding for more than 10 years such as Veekay Cinema Entertainment, Shive International, Poonagary FCSU. Also, we are in the process of settling the balance due to our current	Management should keep available all relevant documents and submitted to auditors to prove the existence, ownership, correctness & completeness of items indicated in the financial statements.
L/C Loan Interest payable	14,420,368	Bank Confirmation		
Advance for sale of Nets	2,633,501	Detail list/ Confirmation		
Creditors	64,133,692	Creditors Confirmations		
Term Loan-Payable within one year	10,000,000			

Paranthan Chemicals	2,000,000	Creditors Confirmations	raw material supplier J.P. Fernando & Sons and therefore, we did not get the confirmation from them.
Paddy Marketing Board	1,000,000		

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(i) Section 50 of Company act Number 7 of 2007,	Issue of Share, immediately following incorporation of a Company under section 5, the Company shall issue to each shareholder named in the application for incorporation the share to which that person is entitled. Even though the Company had issued shares, share certificates had not been issued to its shareholders as the Company incorporated in 2001 and reregistered under the Company act.	The Company had a Stated capital of Rs. 700.00, since its incorporation up to the financial year 2014/15 which consisted of seven shares of Rs. 100 each, issued to seven shareholders. Subsequently, it was cancelled in the year 2015/16 and assets were vested as Stated capital. The previous management had not issued any share certificates and we had sent a request to the General Treasury to guide us on the matter, but we did not get any response.	Share certificates should be issued to shareholders.
ii) Section 151 and 220 of Company act Number 7 of 2007,	Net assets position had gone down to negative of Rs. 104.46 million and Management had not been taken any steps to comply with the requirement of relevant sections.	Company was unable to hold an EGM due to various reasons. But we are hoping to hold an Extraordinary General Meeting in the future and rectify the issues when the situation is favorable.	As per the section 220 of the Company act Company should call EGM and explain the subject to share holders with the plan to overcome same in the future.
iii)Section 9.2(a) Public Enterprises circular No PED/12 of 2nd June 2003	Although two more fishing factories had added to the Company with employees, on 2010 as per cabinet decision, carder had not	The cadre of the Jaffna factory has been approved and we are in the process of getting the cadre approval for the entire staff of	Approval of the line Ministry and concurrence of department of public enterprise

been revised.	Northsea Ltd from the General Treasury	should be obtained to the cadre and the recruitment procedure.

1.7 Non -compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
i) In contrary to the Value Added Tax (VAT) Act No.14 of 2002, Value Added Tax amounting to Rs.184,418,408 (which is to be settled from November 2001 to December 2019) had not been paid by the Company. Further, due to non-payment of VAT on timely basis, company had to pay a penalty of Rs.27, 963,374.	The Company did not pay any penalty for non-payment of Value Added Tax and an appeal has been sent to the Ministry of Finance to waive it.	Management should comply with relevant tax laws to avoid any unnecessary penalty payments.
ii) In contrary to the National Building Tax (NBT) act No 9 of 2009 National Building Tax amounting to Rs.28,580,611 (which is to be selled the period from November 2001 to December 2019) had not been paid by the Company. Further, due to non-payment of NBT on timely basis, Company had to pay a penalty of Rs.4, 713,899 as at that date.	The Company did not pay any penalty for non-payment of Nation Building Tax and an appeal has been sent to the Ministry of Finance to waive it.	Management should comply with relevant tax laws to avoid any unnecessary penalty payments.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs. 101,028,366 and the corresponding profit in the preceding year amounted to Rs. 486,312. Therefore, a deterioration amounting to Rs.100, 542,054 of the financial result was observed. The reasons for the deterioration was due to sales had been decreased by Rs. 121,184,795 Comparing to the previous year and in the previous year Company had received livelihood project grant amounting to Rs.109, 914,354 and during the year under review such grant had received only Rs.4, 453,409.

2.2 Trend Analysis of major Income and Expenditure items

Item	2019/2020	2018/2019	Increase/ (Decrease)	Percentage increase (decrease) %
	Rs	Rs	Rs	
Gross Turnover	260,508,899	245,555,435	14,953,465	6.09
Job Work Income / Sundry sales	332,607	1,301,545	(968,938)	(74.45)
Livelihood Project	4,453,409	109,914,354	(105,460,945)	(95.95)
Rehabilitation Cording Office	-	3,955,365	(3,955,365)	(100.00)
RFO Mannar Rural Organization	-	15,979,346	(15,979,346)	(100.00)
Other Sales	1,951,905	16,899,659	(14,947,754)	(88.45)
Commissions	4,433,304	3,334,052	1,099,252	32.97
Repair & Maintenance - Motor Vehicles	1,372,032	1,079,268	292,764	27.13
Advertising Expenses	2,605,276	195,950	2,409,326	1229.56
Legal fees	289,800	219,000	70,800	32.33
Insurance	502,756	92,372	410,384	444.27
Finance Expenses	17,132,296	11,384,023	5,748,273	50.49

Under mentioned observations are made.

a) Gross turnover of the Company for the year under review had been increased by Rs 14,953,465 or 6.09 percent as compared with preceding year. Meanwhile, Job Work Income / Sundry sales, Livelihood Project, Rehabilitation Cording Office, RFO Mannar Rural Organization, and Other Sales were decreased by 74.45 percent, 95.95 percent, 100 percent, 100 percent, and 88.45 percent respectively,

b) The sales commission had increased by 32.97 percent in the year 2019/20, as direct sales had increased in the year 2019/20 by Rs 14,953,464

c) The Company had to settle an exorbitant advertisement fee in the year 2019/20 comparing to the previous year by Rs. 2,409,326 due to an exhibition held in Jaffna. As a result, the advertising cost had increased by 1230 percent in the year under review.

d) The Company incurred Legal fees for cases filed against it by the Inland Revenue for the nonpayment of VAT liability, pertaining to the years 2011-2015, hence it was increased by 32.33 percent.

e) The Company had to pay an additional insurance premium of Rs. 410,384. For insuring the stocks in the year 2019/20, which had not paid in the year 2018/19, thereby the insurance cost, had increased by 444.27 compare to previous year.

f) The Finance expenses have increased by 50.49 percent due to the accumulation of interest payable on the raw material hypo loan in the year 2019/20.

2.3 Ratio Analysis

The key ratios for the year under review as compared with preceding year are given below.

	31-Mar-20	31-Mar-19
Profitability Ratios		
Gross Profit Ratio	(28.93)	7.78
Net Profit Ratio	(42.69)	0.14
Return on Capital Employed	(1840.59)	0.07
Activity Ratio		
Inventory Day	75	126
Trade Receivable Days	21	16
Trade Payables Day	53	35
Liquidity Ratios		
Current Ratio	0.23 :1	0.43:1
Quick Ratio	0.06:1	0.08:1

2.3.1 Profitability Ratios

a) The gross profit of the Company for the year ended 31 March 2019 was 7.78 percent and it had decreased up to negative value of 23.93 percent by the year under review.

b) The Net Profit ratio also had decreased up to a negative value of 42.69 percent for the year under review from the 0.14 percent of the previous year.

c) The return on capital employed had decreased up to a negative value of 1840.59 percent in the year 2019/20 from 0.07 percent of previous year.

d) The Inventory days' have reduced from 126 to 75 in the year 2019/20

e) Trade receivable days had increased in the year 2019/20 from 16 to 26, due the decrease in Sales Revenue in the year 2019/20.

f) Trade payables days had increased in the year 2019/20 from 35 to 53 and current liabilities had increased in the year 2019/20 due to the accumulation of interest on the raw material facility loan.

3. Operational Review

3.1 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
Even though the factories of the Company situated in Weerawila and Jaffna and permanent buildings had been constructed to the value of Rs.11,247,881, the ownership of the land had not been transferred to the Company name or rather the land had not been leased out to the Company.	The current management of Northsea Ltd will take the necessary steps with regard to the ownership of the lands of the Jaffna and the Weerawila factories respectively.	Management should take action to transfer the ownership of land to the name of Company to avoid any legal issue arise in the future and protect the investment and continuation of business in the same premises.

3.2 Idle or underutilized Property, Plant and Equipment

Audit Issue	Management Comment	Recommendation
The Company had purchased waste water system to Lunuwila factory spending government grant of Rs. 3,076,305 in 2018 and subsequently spent Rs.2, 531,801 in 2019 for the same. However, plant is idling and not functions even by 31 May 2021.	The Company has uncashed the performance bond amounting to approximately Rs. 7.3 Mn pertaining to the waste water treatment plant, for its non-performance and recovered the money partly. This asset was installed by the previous management and they are answerable for its nonfunctional state.	Management should take proper action regarding the idle assets after the investigation regarding on the matter.

4. Accountability and Good Governance

4.1 Annual Action Plan

Audit Issue	Management Comment	Recommendation
As per the public finance circular No 01/2014 on 17 February 2014 an action plan incorporating commercial activity to be implemented in next Financial Year including annual budget, procurement plan, human resource plan, plan for repayment and internal audit plan should be prepared. However, such action plan had not been prepared by the Company for the year ended 31 March 2020.	An action plan was not prepared as we did not receive any grants in the year 2019/2020 and did not have any specific commercial activity to be implemented.	Management should comply with directions given by the relevant circular and prepare action plan to achieve objectives of the Company.