

1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the Milco (private) company for the year ended 31 December 2023 comprising the statement of financial position as at 31 December 2023 and the statement of comprehensive income, statement of changes in equity, cash flow statement for the year then ended and notes to the financial statements, including material accounting policy 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 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 described in paragraph 1.5 of this 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 on the matters described in paragraph 1.5 of this report.

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 Sub-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 Responsibilities for the Audit of the Financial Statements

My responsibility is to issue an auditor's report on the financial statements of the company based on an audit conducted in accordance with Sri Lanka Auditing Standards. However, for the reasons described in the Basis for Disclaimer of Opinion section, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.5 Audit observations on preparation of the financial statements

1.5.1 Non-compliance with the Sri Lanka Accounting Standards

	Non-compliance with reference to the relevant standard	Comments of the Management	Recommendation
(a)	Even though assets, liabilities, income and expenses should not be offset and presented in the financial statements except in cases permitted by the standard in terms of the paragraph 32 of the Sri Lanka Accounting Standards No. 01, The total debit balances in the credit balances, amounting to Rs. 49,039,446, had been identified and offset against the credit balances without making the necessary adjustments and were presented in the statement of financial position. Furthermore, the credit balances in the accounts receivable totaling Rs. 27,325,580 and the credit balances in the accounts receivable totaling Rs. 22,815,176 for office employees, advance deposits and payments made in advance and other accounts receivable had been identified and offset against the debit balances without making the necessary adjustments.	There are some debit balances in the current liabilities of the head office financial statement that have been outstanding for more than 5 years, and The source documents for some of them are difficult to find, while others are based on accounting errors. Actions have now been taken to correct certain balances that arose due to accounting errors.	Actions should be taken in accordance with Sri Lanka Accounting Standards.
(b)	Even though an asset revaluation should be carried out again within a specific period of time after performing an asset revaluation as per paragraphs 31 and 34 of Sri Lanka Accounting Standards No. 16, new revalued amounts had not been entered in the books of accounts since the company had not revalued its assets until the year under review after the revaluation in 2008.	It is expected that attention of the management will be drawn to for conducting an asset revaluation in a coming financial year.	Assets should be revalued and accounted for in accordance with Sri Lanka Accounting Standards.
(c)	As per paragraph 14 of Sri Lanka Accounting Standard 37, provisions should be recognized in the financial statements	According to the available financial records, an annual allocation has been made	Actions should be taken in accordance with

based on the existence of a present obligation, the probability of an outflow of resources from the business in settlement of the obligation, and the ability to estimate its' amount reliably, even though the company had recognized provisions of Rs. 2,180,689 in the financial statements for bonus payments since 2020, without paying attention to it in the context that company is making losses continuously, current liabilities had been overstated by that amount.

for bonuses at the Sri Lanka Polonnaruwa factory from Accounting Standards. the financial year 2015 to 2020. The balance carried forward from the year 2020 is shown in the financial statements as provisions for bonus payments of Rs. 2,180,689. This will be corrected in the financial statements 2024.

- (d) Even though the Expected Credit Loss Method should be used to measure subsequent impairment losses for the trade receivable balance of Rs. 510,957,806 as per paragraph 5.5.15 of Sri Lanka Financial Reporting Standard 09, trade and other debtors in the year under review had been overstated due to this failure to calculate.
- It is expected that the relevant provisions will be made in the accounts using the expected credit loss method for debtors after preparing an accurate debtor age analysis.
- Actions should be taken in accordance with Sri Lanka Financial Reporting Standards.

1.5.2 Accounting deficiencies

	Audit Observation	Comments of the Management	Recommendation
(a)	Even though the company's statement of financial position for the year under review shows a petty cash balance of Rs. 3,784,814, the petty cash balance in the company's financial statements had been understated due to the presence of a total of Rs. 1,763,306 in credit balances of 03 other accounts that had been in existence for a long time within the petty cash balances in the financial statements of the head office.	These balances have been in the accounts for many years and after identifying the evidence and information based on the relevant balances, actions will be taken to correct them in the coming accounting years.	The long-outstanding credit balances in 03 other accounts in petty cash balances should be analyzed, the reasons should be identified, and necessary adjustments should be made.
(b)	Even though the Conversion exchange profit on the long-term advance balance of EUR 201,218 should be Rs. 34,074,094 as per Note 05 of the financial statements as at the end of the year under review, the foreign exchange profit has been overstated by Rs. 829,207 due to accounting that value as Rs. 35,479,314.	The value of the advance as at 31.12.2023 has been calculated based on the exchange rate for the Euro as stated on the website www.exchangerates.org.uk .	When converting foreign currency, the most appropriate accepted exchange rates should be used to convert foreign currency.

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| (c) | Even though a stock of raw materials of Rs. 31,928,087 and a stock of finished goods of Rs.10,327,148, which has not been physically present in the company have been included in the inventory since within the inventory balance of Rs. 1,664,030,771 stated in the financial statements, and No provision had been made in the financial statements for this purpose even by the end of the year under review. Furthermore, information regarding the other stock balance of Rs. 20,713,467 had not been submitted to the audit. | Even though raw material stock balances of Rs. 31 million and finished goods stock balances of Rs. 10 million were in the accounts at the end of the year, the company does not currently have the stock physically in its possession. After identifying the information regarding other balances of Rs. 20.7 million, actions will be taken to correct them in the accounts. | A provision should be made in the financial statements for inventories that are not physically present in the company for several years, and information regarding inventory balances should also be submitted to the audit. |
| (d) | As per the confirmation No. TO/REV/05/33/6 of the Treasury Operations Department dated 01 April 2025, it is stated that no loan has been provided for the project to establish the Badalgama Milk Processing Center and that it has been accounted for as a government investment under the Ministry of Agriculture's 118-2-3-54-2507-0/12 in the year 2021, Even though the Company had disclosed in its financial statements that an amount of Rs. 12,641,310,517 as payable to the Treasury as at December 31, 2023. | After further investigation into this matter, inquiries from the responsible parties and obtaining the relevant approvals, steps will be taken to remove these credit balances from the company's accounts in due course. | Actions should be taken to ensure accurate accounting. |
| (e) | Even though the company's accounting policy states that interest income is recognized on an accrual basis, the interest receivable amount of Rs.6,377,034 receivable within the year under review has not been identified in the financial statements due to that local interest income had been recognized on cash basis as per the schedule. | Since local deposits are accounted for as short-term investments, their interest income is recognized on cash basis. However, actions will be taken to disclose this through accounting policies when preparing financial statements in future years. | Interest income should be identified accurately and accounted for in accordance with accounting policies. |
| (f) | In 2007, the grant amounting to Rs. 12,005,844 received from a private institution from time to time had been accounted for under the balance payable to other parties in the financial statements instead of being recognized annually as deferred income. | Information has been identified that financial grants received by the company from a private institution had been used for the construction of the Ambalantota Milk Cooling Center. Accordingly, | Grants should be identified and accounted for correctly. |

actions will be taken to correct the relevant balances in the final accounts of the coming year.

- (g) An allocation of Rs. 12,096,362 has been made for stocks in the financial statements, and no actions had been taken to identify and remove unusable stocks from the books.
- There has been no shortage of stock here, and only an allocation has been made in the accounts for unusable stocks that were in the warehouse for many years ago. In the future, we will check to see if such stock exists and take steps to remove it from the accounts.
- Actions should be taken to streamline the inventory control of the institution.

1.5.3 Lack of Documentary Evidence for Audit

Item	Amount Rs.	Audit Evidences not provided	Comments of the Management	Recommendation
(a) Balance payable to the National Milk Board	2,108,063	Balance confirmations, age analysis	These balances have been in place for many years and the company cannot find any source documents to support them.	Source documents should be checked and transactions should be accounted for.
(b) Expenses creditors balance mentioned under the trade payable balance of the Polgahawela factory.	25,570,814	Balance confirmations, Age analysis	The company has taken actions to pay the relevant amount to the relevant suppliers during the year 2024. The remaining balance has been corrected in the 2024 accounts.	Accounting procedures should be maintained to provide a age analysis of credit balances and payments should be made to creditors in a timely manner.
(c) The debtor value of the head office and Colombo factory.	388,525,297	Age analysis, Schedules	Age analysis relating to the head office and the Colombo factory will be submitted to the audit in the coming financial years.	Actions should be taken age analysis and schedules should be submitted.

(d)	Trade creditor balance payable to a private company.	30,661,317	Balance confirmations	Letters have been sent via registered mail to the supplier informing them to provide the relevant supporting documents, and reminders have also been sent via email.	Balance confirmations should be submitted and the parties to be paid should be identified and steps should be taken to settle the balance.
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1.6 Accounts Receivable and Payable

1.6.1 Accounts Receivable

Audit Observation

Even though the 3 factories in Digana, Polonnaruwa and Ambewela had outstanding trade debtors balances of over 5 years totaling Rs. 20,678,111 out of the debtors' balances of Rs. 93,993,204, no actions had been taken to recover those balances.

Comments of the Management

Analysis of balances of more than five years in the debtors balances of all factories and the head office has been commenced by now, and action will be taken for recovery after identifying and verifying the information.

Recommendation

Action should be taken to recover outstanding debt balances.

1.6.2 Accounts Payable

Audit Observation

- (a) According to the age analysis presented in relation to the trade creditor balance of Rs. 256,943,646 at the head office, there were balances of Rs. 11,205,608 that were more than 05 years and no actions had been taken to settle those values.

Comments of the Management

Measures had been taken to settle the balances of 2 institutions, among the relevant balances, during the accounting year 2024, and after disclosing accurate information about the other balances, actions will be taken to correct them in the accounts.

Recommendation

After revealing the correct information, actions should be taken to settle the balance.

- (b) Even though there were outstanding retained deposits of Rs. 7,795,228, which were 21 years old, included the balance of Rs. 22,169,976 payable to other parties at the head office, which includes in the other balance payable in the financial statement, no actions has been taken to settle that balance.

The Company will refund the deposits held by the Company after the relevant holding period has expired and the service providers have requested the return of the held funds, and the service providers have not requested the return of the funds to date.

Actions should be taken to settle the balance after revealing the correct information.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a) Paragraph 6.6 of the Operations Manual and 3.1 Guideline of the Public Enterprise Circular No. 1/2021 dated 16 November 2021	Even though the financial statements and draft annual report should be submitted to the Auditor General within 60 days of the end of the accounting year, the financial statements for the year 2023 had been submitted on 23 May 2025. Accordingly, there was a delay of 448 days in submitting the financial statements. Furthermore, the draft annual report had not been prepared and submitted with the financial statements as stated in Annex 3 of the guidelines applicable to public enterprises.	No comments has been made.	Financial statements and annual reports should be prepared and submitted for audit in accordance with the provisions of the circular.
(b) Guideline 4.2.1.(b) of the Procurement Guidelines	The company had not prepared a master procurement plan for a period of at least three years and a regularly updated procurement plan for the year 2023.	No comments has been made..	A procurement plan should be prepared in accordance with the Procurement Guidelines.

1.8 Finance Management

	Audit Observation	Comments of the Management	Recommendation
(a)	The overdraft interest expense incurred during the year under review on the bank overdraft facility of Rs. 1,200,000,000 by securing the US Dollar fixed deposit for the bank overdraft was Rs. 323,947,216, and attention had not been paid to minimizing the additional cost of Rs. 199,587,316 since the related fixed deposit interest income was Rs. 124,359,900.	The bank has charged the relevant interest according to the amount of overdraft facility used in 2023, and it has exceeded the interest income related to the fixed deposit pledged. However, even though you applied for a reduction in the interest rate on the overdraft facility, the bank has informed the company that it is not possible to reduce the bank overdraft interest rates.	Necessary measures should be taken to minimize bank overdraft balance.

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| (b) | The sinking fund worth Rs. 1,689,978 stated in the statement of financial position was a balance that had been in existence for many years. Even though it had been disclosed under Note 12 of the financial statements that the funds would be utilized for milk purchases in future years based on financial need, action had not been taken accordingly. | This balance is also expected to be re-included in the retained earnings, subject to approval of the top management of the company in due course since the relevant fund is a balance that has availed for many years and since an equivalent amount is not maintained in a separate bank account for the same. | Actions should be taken as disclosed under Note 12 to the financial statements. |
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1.9 Non-compliance with tax regulations

	Audit Observation	Comments of the Management	Recommendation
(a)	The balance due to other government institutions in the financial statements includes Rs. 396,413 in security tax payable and Rs. 436,133 in PAYE tax payable, totaling Rs. 832,546 since 2002, and no action had been taken to settle that balance until the year under review.	This is a value recorded in year 2002, and no action had been taken to pay the relevant amount since no notice has been issued recently to the company to pay the fines. However, it is expected that this balance will be investigated and resolved in due course.	Action should be taken to settle the relevant balance.
(b)	No measures had been taken by the end of the year under review to settlement the balance of income tax fines amounting to Rs. 8,425,296 due for many years.	Since the fines for income taxes payable had been recorded around the year 2003, there is no information in the accounts department to confirm the relevant balance.	The relevant taxes should be paid after revealing the correct information.

2. Financial Review

2.1 Financial Result

The operating result for the year under review was a loss of Rs.501,491,702 and the corresponding loss of the previous year was Rs.473,942,776. Accordingly, a deterioration of Rs.27,548,926 was observed in the financial result. This deterioration had been mainly resulted from the increase in cost of sales and administrative expenses, finance expenses and foreign exchange loss.

2.2 Trends Analysis of main Income and Expenditure Items

The company's other income decreased by 92 percent compared to the preceding year, mainly due to the foreign exchange profit of the previous year turning into a foreign exchange loss in the year under review. Furthermore, financial income had decreased by 8.11 percent while finance expenditure had increased by 178 percent. Administrative expenses and other expenses had increased by 24 percent and 907 percent respectively compared to the previous year.

2.3 Ratio Analysis

- (a) The company's gross profit margin for the year under review was 10.11 percent and the net loss ratio was 3.11 percent. Similarly, earnings per share were minus 0.55 in the year under review and it was minus 0.54 in the previous year. Accordingly, no earnings were made on the share capital during the year under review and it was observed that the institution's operational inefficiency and poor performance had adversely affected the company's survival.
- (b) The company's leverage ratio, i.e. when the total assets and total liabilities are considered, was 0.72 in the year under review, despite the fact that liabilities had not exceeded total assets. i.e. the company's total debt was 72 percent compared to total assets. This rate was 71 percent in the preceding year. The company's total capital to debt ratio was 2.2 in the year under review. Accordingly, it was observed that the company's debt capital was at a high level and that asset financing had been carried out on debt capital.

3. Operational Review

3.1 Management Inefficiencies

Audit Observation	Comments of the Management	Recommendation
(a) Even though the construction and installations worth Rs. 5,548 million has been carried out by the company on the land on which the Ambewela factory is located, which is 40 acres 01 rood 36 perches owned by the government under survey plan number 4754, surveyed on 10 March 1980, the ownership of this land had not been acquired by the company until 31 December 2023.	Even though the government has taken a policy decision to grant lease deeds for the relevant land and 37 other lands to the company on a 50-year lease basis, the government has not taken steps yet to issue those deeds.	Necessary steps should be taken to transfer ownership of the land to the company.
(b) The ongoing works include the construction of the Gatambe outlet, the installation of the ice cream cup and cone filling machine at the Digana Dairy Factory and the modernization of the Polonnaruwa, Ambewela and Digana factories, with a balance of Rs.	Since the construction of the outlet in the Gatambe area of Kandy has not yet been completed, an amount of Rs. 150,000 paid for it is included in the work in progress. The ice cream cup and cone filling	Action should be taken to complete the construction and renovation work and to achieve the desired objectives.

150,000, Rs. 15,445,587 and Rs. 809,899,705 respectively has been continuously carried forward since year 2012, and the said construction and renovation work had not been completed.

machine purchased for the Digana factory a few years ago worth Rs. 15,445,887 has not yet been brought to a usable level, so it has also been included in the ongoing work. Even though an amount of Rs. 809,899,705 had been spent on the Digana factory, that value has also been included in the ongoing work since the renovation work has not been completed yet.

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| (c) | Information regarding the distribution of the milk cooler stock and Bottle & Deep Freezer stock amounting to Rs. 13,368,045 included in the closing stock balance of the year under review had not been submitted to the audit during the subsequent inspection regarding that stock. | The information on the relevant milk cooler stock is currently being disclosed and once the relevant information is identified, it will be submitted to the audit. Similarly, since the balance of bottles and freezers was an accounting error, actions had been taken to correct it in the accounting year 2024. | Information related to the distribution of the relevant stocks should be submitted to the audit. |
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3.2 Operational Inefficiencies

	Audit Observation	Comments of the Management	Recommendation
(a)	In 2023, 125,674 no. of 750-gram butter packets had been sold to employees at Rs. 330 each for the welfare of the company's employees, generating an income of Rs. 41,472,420, and the company had incurred a loss of Rs. 77,163,836 from the butter packets issued for employee welfare due to the charging of a price that did not cover the production cost of Rs. 118,636,256 incurred for that purpose.	It is expected to take necessary measures to charge a price that covers the cost of production when selling this item on a welfare basis in due course.	Necessary measures should be taken to charge a price that covers the cost of production.
(b)	When the sales figures for the year under review compared to the sales of the previous year, the 900ml product decreased from 5,468,308 units to 2,948,320 units, or 46 percent, UHT milk (plain) 450ml production also decreased from 6,817,706 units to 4,416,517 units, i.e. by 35 percent.	The main reason for the decline in sales was the inability to make the target production due to the complete breakdown of the UHT production machine at the company's Polonnaruwa factory during April and May 2023, and also subsequent	Action should be taken to achieve annual production and sales targets.

repairs during June, July and August 2023 due to the faulty condition of the production machine. Similarly, the decrease in sales was also due to the company's inability to achieve its target production capacity due to the decrease in the number of liters of liquid milk purchased by the company in the year 2023 compared to the year 2022.

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| (c) | <p>Only the Ambewela factory, out of the company's 5 factories engaged in manufacturing activities, reported profits in year 2022 and 2023. The other 4 factories that is Digana, Polgahawela, Polonnaruwa and Colombo had reported losses in year 2022 and 2023, and the total loss of those 04 factories in year 2022 and 2023 was Rs. 1,000,747,087 and Rs. 345,248,601 respectively.</p> | <p>The increase in the prices of all raw materials including packaging, the decrease in their supply, the difficulty in procuring the basic input material that is raw milk under the prevailing travel restrictions and having to incur higher financial costs to procure working capital caused Milco to incur losses during the period under review. Also, the reason for only the Ambewela factory reported profits while other factories reported losses was the types of products manufactured at the Ambewela factory require a limited amount of raw materials compared to other factories, and the difficulties experienced have resulted in reduced production levels and increased operating costs of other factories.</p> | <p>Actions should be taken to make factories engaged in manufacturing profitable.</p> |
| (d) | <p>The amount of liquid milk liters collected by the company during the period from 2021 to 2023 ranged between 67 percent and 71 percent of the expected amount of milk to be collected. Accordingly, the amount of liquid milk collected during the relevant period had continuously</p> | <p>The decline in milk in 2022 compared to 2021 was due to the entry of competitive milk collectors into the dairy industry and their purchase of milk without regard to its quality. Similarly, the decline in milk in year 2023 compared to</p> | <p>Efforts should be made to achieve the desired goals for milk collection, which is the main ingredient for the company's products.</p> |

decreased from 67,905,259 liters of milk to 39,775,076 liters. Further, it was also observed that the percentage of milk collected by the company out of the whole liquid milk production in the country had decreased from 13 percent to 8 percent during the relevant period.

2022 was primarily due to the failure of Milco to increase milk prices at the right time compared to other competitors.

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| (e) | <p>The company continued to decrease the number of units produced in year 2023 compared to year 2021, out of 11 product types produced by the company, namely UHT milk, sterilized milk, yogurt, Ghee oil, butter and milk powder. It was observed that the number of production units in year 2023 had decreased compared to 2021, ranging from a minimum of 52,921 units to a maximum of 8,607,299 units. Although the products of condensed milk and ice cream showed an increase in the reporting year compared to 2022, the production units had decreased compared to the number of units in year 2021.</p> | <p>Production also decreased in proportion to the decrease in the collection of raw milk, the basic raw material for products. The limited quantities of milk that availed had been divided among each product type and production had been carried out in accordance with market demand.</p> | <p>Action should be taken to carry out production activities adequately to protect and grow the company's market share.</p> |
| (f) | <p>Factories utilize less than 50 percent of their existing production capacity to produce pasteurized milk, sterilized milk, UHT milk, butter, Ghee oil and milk powder, and factories are only using between 50 percent and 75 percent of their available production capacity to produce yogurt, ice cream and condensed milk. Further, it was also observed that cheese production is carried out only at the Digana factory, which had reached maximum capacity.</p> | <p>Production also decreased in proportion to the decrease in the addition of raw milk, the basic ingredient for products. The limited quantities of milk available had been divided among each product type and production had been carried out in accordance with market demand.</p> | <p>Actions should be taken by the factories to maximize the utilization of their existing production capacity.</p> |

- (g) The volume of liquid milk sales had continuously decreased from 20,538,423 liters to 13,258,335 liters during the period from 2021 to 2023, and it was observed that this was a 35 percent decrease compared to sales in year 2021. Further, it was also observed that sales of yogurt, Ghee, butter and condensed milk products continued to decline from year 2021 to 2023.
- Overall liquid milk production has also decreased in proportion to the decrease in total milk production. Similarly, sales volumes have also decreased in proportion to production.
- Action should be taken by the company to protect and grow its market share.