

## **Board of Investment of Sri Lanka-2012.**

### **1. Comments on Financial Statements**

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#### **1.1 Qualified Opinion**

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In my Opinion, except for the effects of the matters described in paragraph 1.2 of this report, the financial statements give a true and fair view of the financial position of the Board of Investment of Sri Lanka (BOI) as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

#### **1.2 Comments on Financial Statements**

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##### **1.2.1 Non-compliance with Sri Lanka Accounting Standards (SLAS)**

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###### **(a) LKAS 40**

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Buildings value of which can be measured reliably and held for future economic benefit had not been identified as an Investment property.

###### **(b) LKAS 39**

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Even though the staff loans amounting to Rs. 509, 922,787 had been identified as a financial asset in the statement of financial position, it had not been measured at amortized cost by using the effective interest rate method as at 31 December 2012.

##### **1.2.2 Accounting Deficiencies**

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Completed contracts valued at Rs.293, 829,237 had been shown in the accounts as work in progress as at 31 December 2012 instead of being transferred to the relevant assets accounts.

##### **1.2.3 Accounts Receivables and Payable**

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###### **(a) Dues from Enterprises**

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The details of dues from the BOI approved enterprises, provision for impairments and bad debts written off thereon, as at the balance sheet date as compared with proceeding four years are given below.

Description	2012	2011	2010	2009	2008
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	Rs.	Rs.	Rs.	Rs.	Rs.
Dues to BOI from Enterprises	701,884,118	623,861,381	631,911,594	593,483,063	539,768,967
Provision for impairments	492,790,570	437,041,560	249,452,238	227,775,883	199,355,398
Provision for impairment as a percentage of total dues	70%	70%	39%	38%	37%
Bad debts written off during the year	5,517,032	73,113,266	8,306,417	9,279,995	8,994,408

Following observations are made in this regard.

- (i) Provision for impairment on dues from enterprises had rapidly increased during the last five years from 37% in 2008 to 70% in 2012 thus indicating poor recoverability of dues.
- (ii) Out of total provision for impairment of Rs. 492,790,570, a sum of Rs. 472,348,646 or 96% represented 100% impairment had been made on dues from cancelled and closed down projects as at 31 December 2012.
- (iii) A provision for impairment of Rs. 210,335,393 had been made for annual fees, which was 86% of total annual fees of Rs. 245,726,709.

**(b) Other Debtors**

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 The details of the long outstanding balances of other debtors of the BOI and provision for impairment as at the balance sheet date as compared with the preceding three years are given below.

Description	2012	2011	2010	2009
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	Rs.	Rs.	Rs.	Rs.
Other Debtors	66,891,763	61,204,152	103,810,214	102,967,791
Provision for Doubtful Debts /impairment	61,204,152	7,688,630	48,234,339	48,171,157
Provision for Doubtful Debts/impairment as a Percentage of the total	91.5%	12%	46%	47%

Following observations are made in this connection.

- (i) Impairment on other debtors represented 91.5% thus indicating poor recoverability of dues.
- (ii) Out of the total amount of other debtors amounting to Rs. 66,891,763 as at end of the year, 87% or Rs. 58,441,942 represented dues from five Government Institutions whose outstanding for more than four years. However, proper action had not been taken by the BOI to collect dues from those Government Institutions.

#### 1.2.4 Non-compliances with Laws, Rules, Regulations and Management Decisions

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The following non-compliances were observed in audit.

Reference to laws, rules or regulations	Non – compliances
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(a) Public Finance Circular No.PF/PE/6 dated 31 January 2000	The PAYE Tax amounting to Rs. 155,847,565 had been paid out of the BOI's fund for the period from 1997 to 2012 instead of recovering PAYE Tax from employees as per the circular instructions.
(b) Section 30 (2) of the Sri Lanka Board of Investment Act No.04 of 1978 and Section 10 (3) of the Finance Act No. 38 of 1971.	The BOI had maintained the Staff Benevolent Fund without obtaining the Finance Minister's approval with the concurrence of the line Minister in terms of the said act.

- (c) The Public Enterprises Circular No. PED/10 dated 28 May 2003. The BOI had calculated the compensation of employees those who had retired under the Voluntary Retirement Scheme (VRS) including all allowances such as 5% special allowance, cost of living, attendance incentive, acting, fuel, professional ,annual leave, drivers allowances etc contrary to the said circular.
- (d) Public Administration Circular No. 14/2008 of 26 June 2008. The employees of the BOI who had enjoyed monthly transport allowance of Rs. 30,000 together with fuel allowance had further enjoyed monthly driver's allowance of Rs.15, 000 contrary to the circular instructions.
- (e) The paragraph 04 of Public Enterprises Circular No. PED/39 of 09 October 2006 and paragraph 03 of Public Administration Circular No.22/99 of 08 October 1999. The ownership of leased hold vehicles had been transferred to thirteen officers at their retirement at residual values contrary to the circulars. As a result, a loss of Rs. 45,498,876 had incurred to the BOI up to transmission of ownership of the vehicles.

## **2. Financial Review**

### **2.1 Financial Results**

According to the financial statements presented, the operations of the BOI for the year ended 31 December 2012 had resulted in a pretax net profit of Rs.268, 085,167 as compared with the corresponding pre-tax net profit of Rs.119, 101,824 for the preceding year, thus showing an increase of Rs.148,983,343 or 125 % in the financial results as compared with the preceding year.

Revenue of the BOI had increased by 11% due to increase of agreement processing fees, annual fees, ground rent and land premium during the year under review as compared with the preceding year.

Further, the BOI had earned an operating profit of Rs.137, 599,489 during the year under review, as against the operating loss of Rs.23,558,385 during the preceding year thus indicating an increase in operating profit by Rs 161,579,647 .

## 2.2 Analytical Financial Review

(a) Significant data about the financial results for the year under review and the corresponding figures for the preceding year is given below.

	Year ended 31 December	
	2012	2011
	Rs.	Rs.
Operating Income	2,226,369,460	2,004,951,097
<u>Less: Operating Expenses</u>	(2,088,769,971)	(2,028,509,481)
Operating Surplus/ (Loss)	137,599,489	(23,558,385)
Net Finance Income	130,485,678	142,660,209
Surplus before Tax	268,085,167	119,101,824
<u>Less: Tax on Interest Income</u>	(28,960,401)	(32,935,760)
Surplus after Tax	239,124,766	86,166,064
<u>Add: Other Comprehensive Income:</u>		
Actuarial Gain/(Loss) on obligation	(10,046,932)	18,825,926
Net Surplus for the year	<b>229,077,834</b>	<b>67,340,138</b>

(b) Financial review of the Export Processing Zones, Export Processing Parks, Industrial Parks, Regional Offices and New Economic Zones is given below.

Component	Revenue	Operating Expenses	Operating Profit	%	Profit After Tax	%
	Rs. (,000)	Rs. (,000)	Rs. (,000)		Rs. (,000)	
Head Office	588,477	894,683	(306,206)	-52%	(212,671)	-36%
<u>Export Processing Zones:</u>						
Katunayake	512,710	392,814	119,896	23%	122,412	24%

Biyagama	344,928	272,768	72,160	21%	74,283	22%
Seethawake	280,027	129,389	150,638	54%	151,083	54%
Mirigama	31,155	37,940	(6,785)	-22%	(6,666)	-21%
Wathupitiwala	40,656	48,795	(8,139)	-20%	(7,873)	-19%
Horana	138,611	75,008	63,603	46%	63,743	46%
Mawathagama	33,667	24,007	9,660	29%	9,750	29%
Polgahawela	36,305	16,131	20,174	56%	20,222	56%
Koggala	91,129	104,071	(12,942)	-14%	(12,105)	-13%
<u>Export Processing Parks:</u>						
Malwatta	12,992	18,601	(5,609)	-43%	(5,553)	-43%
<u>Industrial Parks:</u>						
Kandy	92,892	49,751	43,141	46%	43,876	47%
Mirijjawila	2,394	1,915	479	20%	479	20%
<u>Regional Offices:</u>						
NorthWestern	4,521	27,004	(22,483)	497%	(21,881)	484%
North Eastern	23,630	3,619	20,011	85%	20,024	85%
Total	2,234,103	2,096,503	137,599		(1,821,304)	

The BOI had carried out its functions through 9 Export Processing Zones (EPZ), one Export Processing Park (EPP), 2 Industrial Parks (IP) and 2 Regional Offices (RO). According to the above information following observations are made.

- (i) The operating profit from head office had drastically decreased in last three years and an operating loss had incurred in the year under review.

Year	Profit/ (Loss) Rs.
2009	55,205
2010	45,582
2011	12,735
2012	(306,206)

- (ii) 3 Export Processing Zones and the Export Processing Park had incurred losses continuously since 2007 to 2012 due to huge administration cost. Details are as follows.

	2012	2011	2010	2009	2008	2007
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<u>Export Processing Zones</u>						
Mirigama	(6,620)	(11,418)	(11,584)	(18,720)	(22,978)	(16,624)
Wathupitiwala	(7,766)	(15,743)	(13,703)	(12,787)	(11,872)	(18,214)
Koggala	(11,775)	(26,980)	(17,503)	(23,149)	(23,412)	(42,364)
<u>Export Processing Parks</u>						
Malwatta	(5,531)	(3,226)	(3,458)	(3,639)	(2,576)	(6,237)

### 2.3 Working Capital Management

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(a)	<u>Liquidity Ratio</u>	2012	2011	<u>Observation</u>
(b)	<u>Activity Ratios</u>			
	Debtors turnover Ratio – times	3.17	3.27	Debt collection was not in a satisfactory level
	Debtors turnover period - days	115	113	Poor debt collection.
	Current Ratio - Actual	1.2	3.29	Huge reduction of current ratio and Sufficient working capital was not available.
	- Standard	2	2	

### 3. Operating Review

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#### 3.1 Progress of the BOI Projects

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Following observations are made.

- (a) Details of projects approved under Section 17 of Sri Lanka Board of Investment Act and signed agreements, the total number of cancelled and closed down or suspended projects and per centages (%) compared with agreement signed projects during the year 2012 and the 10 preceding years are given below.

	Agreement signed Projects <sup>√1</sup>	Cancelled Projects <sup>√2</sup>	Closed down and Suspended Projects <sup>√3</sup>	Total No. of Projects Cancelled, Closed down and Suspended
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2002	202	68	3	71
2003	272	55	3	58
2004	274	75	7	82
2005	208	121	8	129
2006	258	113	14	127
2007	310	119	18	137
2008	252	107	22	129
2009	182	93	33	126
2010	269	124	61	185
2011	165	47	20	67
2012	171	80	42	122
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Total	2,563	1002	231	1,233
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<sup>√1</sup> Including Agreement Cancelled/Closed down/Operation Suspended projects and Expansions

<sup>√2</sup> Agreement Cancelled after commercial operation commenced (Excluding cancellations of expansions)

<sup>√3</sup> Closed down/Suspended after commercial operation commenced (Excluding close down/suspended of expansions)

- (i) Number of cancelled, Closed down and Suspended Projects had been increased by 82% as compared with previous year.
- (ii) Number of agreement signed projects had been dropped up to 163 during the year under review and it was the minimum registration as compared with last 10 years.



- (iii) 123 projects or 53% had been closed down and suspended during the period 2010 to 2012.

- (b) Foreign Direct Investments and Local Realized Investments made through the BOI during the period from 2006 to 2012 are given below.

Year	Foreign Direct Investments (FDI)	Local Realized Investments
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	US\$ Mn.	US\$ Mn.
2006	603	400
2007	734	490
2008	888	226
2009	601	151
2010	516	433
2011	1066	426
2012	1338	608

Foreign direct investments had been increased by 106 per cent in the year 2011 and 25 per cent in the year under review. Further, Local realized investments had been increased by Rs.182 mn in the year under review which was a 43% increase when compared with the previous year.

### 3.2 Management Inefficiencies

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The following observations are made.

- (a) The BOI had signed a lease agreement with a private company in respect of the level 12, of West tower of the World Trade Centre building on 04 November 1996 and had paid Rs. 2,637,240 as a deposit. Although such office space had been handed over to the above company in June 2010, the BOI had not recovered such deposited amount until May 2013.

*The Chairman informed me that as a result of suddenly evacuating the then Ministers Office from the level 12, the lesser had forfeited the security deposit of Rs. 1,303,020 as it was not given the prior notice regarding evacuation.*

- (b) The BOI had paid compensation amounting to Rs.618,530 to the former Senior Manager (Internal Audit) in the year under review as per the final determination

delivered by the Labour Tribunal for the case filed by him against the decision of non-extension of the service beyond the optional age of retirement of 58 years.

- (c) The management of the BOI had entered in to an agreement with a Malaysian Company to construct a housing scheme in the year 1998 in Wathupitiwala Export Processing Zone. Following observations are made in this regard.
- (i) Due to poor performance of the company, approval granted had been withdrawn and the scheme with 34 houses had been taken over by the BOI.
  - (ii) Constructed houses had been awarded to another company for auction the houses. However, no any evidence was made available to audit to prove the existence of an agreement between auctioneer and the BOI.
  - (iii) A sum of Rs. 1,604,200 had remained as receivable from that company for over 5years without being recovered.
  - (iv) Twenty five housing units valued at Rs. 24,216,500 had been sold at a selling price of Rs. 19,772,192. As a result, a loss amounting to Rs.4, 444,308 had incurred to the BOI.
  - (v) Two housing units had been allocated for the security personnel attached to the former Minister of the line ministry since 2006 under the installments basis.
- (d) The BOI had reimbursed overtime amounting to Rs. 3,771,885 made to customs officials deployed by the Sri Lanka Customs at two verification units of Central Verification Terminal (CVT), Orugodawatta and Air Cargo Village Unit (ACVU), Katunayake durring the year 2012 without verifying the attendance records of customs officers attached for its correctness. According to the records submitted by the Department of Customs some of the officers had worked more than 600 hours per month.

*The Chairman informed me that the BOI had reimbursed overtime payments to Sri Lanka Customs merely according to the conditions stipulated in the Section 4.1 of the Memorandum of Understanding signed between the two institutions.*

- (e) Two companies had entered into an Agreement with the BOI on 22 December 2005 to set up and operate their business activities in Lot Nos.26 B and 26 B/1/B situated at Biyagama Export Processing Zone (BEPZ). The Following observations are made in this regard.
- (i) The BOI had informed to the above two companies to re-locate their projects in the land and premises at lot Nos.43 & 43 A in Block “A” which was

previously occupied by another company and had been closed down at that time without stating any reason.

- (ii) Subsequently the BOI had informed the above two companies to pay Rs.59 Mn. as a compensation for the value of the buildings constructed in the premises as claimed by the closed company.
  - (iii) Finally one company out of above two had ended up before arbitration and therefore the BOI had to pay a compensation of Rs.32, 719,097 in the year 2011 for the losses occurred due to termination of activities of the project.
  - (iv) Further BOI had decided to pay a sum of Rs.7,178,111 as a compensation to the second company for the losses occurred by them in the year under review.
- (f) The BOI had paid an advance of Rs.1, 301,584 to Horana Pradeshiya Sabha on 12 January 2010 to construct the proposed treated effluent pumping plant at Horana Export Processing Zone. But this project had been suspended due to protest regarding discharge of treated effluent to river Kalu Ganga upstream at Kandana. However this advance had not been recovered by the BOI until June 2013 and this amount had been shown as work in progress as at 31 December 2012.
- (g) The BOI had agreed with a Rubber manufacturing company situated at Horana Export Processing Zone, to reimburse the electricity tariff if the rates that prevailed on 29 December 2000 had increased over 6.9 per cent per annum. Following observations are made in this regard.
- (i) The company had claimed a sum of Rs. 356,793,568 in respect of increased rate of electricity tariffs during the period of June 2002 to September 2007 and a sum of Rs. 388,161,877 in respect of interest on delay in the payment of indemnity and the arbitration cost incurred by the company in terms of the final decision awarded by the International Court of Arbitration of the International Chamber of Commerce. The Court of Arbitration had given a verdict in favor of the Company and the matter is still under litigation.
  - (ii) The BOI had not obtained an assessment report from the Rubber Development Department and Rubber Research Institute for the availability of rubber wood in this area for consumption before granting the approval for the Project.
  - (iii) Due to pending the court cases, the BOI was unable to recover ground rental, water bills and bungalow rental etc. due from this company to BOI.
- (h) The Perth Estate was purchased by the BOI and part of the Estate had been handed over to the State Plantations Corporation for management for a period of five (5) years. The following observations are made in this regard.

- (i) The assets such as buildings, valuable trees, etc. in the Estate had not been recorded after the purchase.
- (ii) The BOI had not received the accounts of the Institution since 2006 from the SLSPC.
- (iii) The Corporation had not remitted the profits regularly to BOI except a sum of Rs.10 million made in the year 2005. As per the accounts submitted for the year 2006, amount due from the SLSPC pertaining to Perth Estate was Rs.16.47 Million. However the BOI was unable to identify and record the correct amount receivable as directed by the Committee on Public Enterprises held on 15 November 2011 and 14 November 2012.
- (iv) Resolving matters pertaining to Perth Estate contrary to the conditions of the agreement such as increasing the management fees by 15 per cent, unilateral utilization of revenue of the Perth Estate, Investment of revenue amounting to Rs. 20 million generated from Perth Estate in fixed deposits in the name of the contractor, Unauthorized transfer of motor vehicles and bungalow rental amounting to Rs. 12.42 million through the current account to the contractor are in progress.

### **3.3. Assets Management**

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- (a) The BOI had purchased 04 condominium units in the West Tower of the World Trade Centre (WTC) at a cost of Rs. 530 million on 31 December 2007 and further 05 units in the same tower had later been purchased at a cost of Rs. 625 million on 05 March 2008 which the BOI had occupied since September 2000 on lease basis. Following observations are made in this regard.
  - (i) The level six, purchased at a cost of Rs.128 million, had been entirely evacuated with effect from 01 July 2011 to be rented out and remained idle up to 31 December 2012. However, as per the Chairman's comments, part of such floor area had been utilized for the office space of the Ministry of Investment Promotions in 2013 and other part will be utilized for relocating the Investor Service Department of the BOI.

*The Chairman informed me that after the establishment of newly formed Ministry of Investment Promotion, it was required to find an office space in the WTC building to setup the Ministry Office and therefore part of the level 06 was utilized for this purpose. Further BOI decided to relocate the Investor Services Department to the balance floor area of level 06 WTC.*

- (ii) A floor area of 6,318 Ft<sup>2</sup> of the level 25 and floor area of 2,781 Ft<sup>2</sup> of the level 27 had been allocated for the Ministry of Economic Development, without entering into an agreement and without charging any rental for the usage.

### 3.4. Human Resource Management

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The BOI had not taken proper actions to fulfill the requirements in terms of Section 9.3 of the Public Enterprises Circular No. PED/12 of 2 June 2003 on Public Enterprises Guidelines for Good Governance for effective cadre management. Following observations are made in this regard.

- (a) Hundred and ten (110) vacancies in different categories of the staff, including 73 of executive staff (including the key post of Director, Internal Audit) had not been filled even up to 31 December 2012. Details are as follows.

Description	No. of Employees in approved carder	Actual number of Employees			Vacancies
		Permanent	Contract	Total	
Executive Staff	575	497	5	502	73
Clerical and Allied Staff	354	330	4	334	20
General Service Staff	321	272	32	304	17
<b>Total</b>	<b>1,250</b>	<b>1,099</b>	<b>41</b>	<b>1,140</b>	<b>110</b>

- (b) According to the Internal Circular of BOI, No ES/12/EST/188 dated 23 March 2011, VRS is formulated for employees who wish to retire prematurely provided their vacancies should not be filled or where their vacancies could be filled by another who could be released for the purpose. However, the BOI had released one officer who had been deployed in a main key post of Executive Director (Finance) without considering the above Circular provisions.

### 3.5 Identified Losses

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The BOI had initiated actions to vest 250 acres of land owned by the Forest Department located at Sellakanda , Puttlama to set up an investment zone in the year 2006 and had incurred Rs. 11,270,120 as preliminary expenses such as carrying out an Environmental impact assessment, Investigation of ground water, Pre structural design and drawings, Geotechnical Investigation, preparing survey plans etc. It was observed that the BOI had

taken actions to suspend the vesting process of the land and to write off the above amount of preliminary expenses during the year 2012 with the Board approval.

#### **4. Accountability and Good Governance**

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##### **4.1 Corporate Plan**

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Out of the targets stated in the Corporate Plan for the period 2009 to 2013, the BOI had failed to achieve some of the targets set out. Following observations were made in this regard.

- (a) Although it was targeted to identify and promote new investment promotion zones at Batticaloa and Ampara in 2009/2010, the BOI had not initiated any action to establish any Investment Promotion Zones in those areas even up to 31 December 2012.
  
- (b) Out of 300 new enterprises targeted to setup outside Colombo and Gampaha districts by 2009/2010, only 163 projects had started operations (including 5 expansions) and 18 projects had been under implementation as at 31 December 2012.

##### **4.2 Action plan**

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An action plan for the year under review had not been prepared.

##### **4.3 Audit Committee**

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According to Section 9.12 of the Public Enterprises Circular No. PED/12 of 02 June 2003, the Audit Committee should have met on a regular basis at least once in three months and should have submitted its observations to the Board of Directors with their recommendations for necessary actions. However, only one audit committee meeting had been held in the year 2012.

##### **4.4 Budgetary Control**

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Significant variations between the budgeted and the actual income and expenditure had been observed, thus indicating that the budget had not been made use as an effective instrument of management control.

**5. Systems and Control**  
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Weaknesses in systems and controls observed during the course of audit were brought to the notice of the Chairman of the BOI by my detailed report issued in terms of Section 13(7)(a) of the Finance Act. Special attention is needed in respect of the following areas of control.

- (a) Compliance with Laws, Rules and Regulations
- (b) Monitoring of Projects
- (c) Debt Collection
- (d) Personnel Management
- (e) Assets Management