

Lanka Sugar Company (Pvt.) Limited - 2017

The audit of financial statements of the Lanka Sugar (Pvt.) Company Limited for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of profit and loss and other comprehensive income and the statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory 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. My observations on the functions of the Company which I consider should be report to Parliament in terms of Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka appear in this report.

1.2 Board of Directors Responsibility for the Financial Statements

The Board of Directors is responsible for the preparation and fair preparation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based in my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial Statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 The Basis for the Qualified Opinion

- (a) Although the fully depreciated property, plant and equipment cost at Rs. 1,425,160,007 were being used by the Company, the effective economic life of those assets had not been reviewed, revalued and made necessary adjustments.
- (b) When computing the deferred tax assets / liabilities, the tax rate at the end of the accounting period should be used in terms of Inland Revenue Act No. 24 of 2017 and Paragraphs 46 and 47 of the Sri Lanka Accounting Standard No. 12. Nevertheless, because of the Company had used a 12 per cent tax rate instead of the 28 per cent tax rate, the deferred tax expense for the year under review had been understated by a sum of Rs. 295,600,375 .
- (c) Necessary actions had not been taken by the Company to recover the balance of trade and other receivables from the year 2014 amounted to Rs 1,184,931 .
- (d) Although the advances paid to suppliers and service providers amounting to Rs. 3,379,359 and Rs. 1,037,081 respectively had remained since 2013 , necessary steps had not been taken by the Company to recover them.
- (e) Actions had not been taken to settle the surcharges payable to the Employees Provident Fund and the Employees Trust Fund since 2011 amounted to Rs. 13,658,977 .
- (f) The loans granted to the farmers amounting to Rs. 592,468,478 by the Pelwatte Sugar Company had not been settled since 1987 .
- (g) Although the balances of loan provided by Sevanagala Sugar Company to farmers amounting to Rs.45,689,091 had remained from 2 to 6 years without recovery, the Company had not taken necessary steps to recover those balances.

1.5 Qualified Opinion

In my opinion, except for the effects of the matters described in 2.2 of this report, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2. Report on Other Legal and Regulatory Requirements

I explain the following matters in terms of section 163 (2) of Companies Act, No. 7 of 2007 .

- (a) The basis for the opinion and the scope and the limitations of the audit are as set forth in Paragraph 2.2 .

(b) In my opinion,

- Except for the effect of the matters described in the Basis for Qualified Opinion paragraph, I have obtained all the information and explanation that required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company,
- The financial statements of the Company comply with the requirement of Section 151 of the Companies Act, No. 07 of 2007.

3. Non-compliance with rules, regulations and management decisions

The following instances of non-compliance with the laws rules and regulations were observed.

Reference to Laws, Rules and Regulations -----	Non-compliance -----
<p>(a) Companies Act No. 07 of 2007</p> <p style="margin-left: 40px;">(i) 131 Section</p> <p style="margin-left: 40px;">(ii) 133 Section</p>	<p>Although an Annual Report should be submitted to the Registrar of Companies within 30 working days from the date of the Annual General Meeting of the Company, the Annual Report had not been prepared by the Company for the year under review.</p> <p>Even though the Board of Directors of the Company shall call an Annual General Meeting of Shareholders to be held once in each calendar year not later than six months after the date of the Balance Sheet of the Company and on a day not later than fifteen months after the previous Annual General Meeting , such a meeting had not been held by the Company from the year 2014 .</p>

4. Operating Review

4.1 Activity and Review

The Pelwatte Sugar Company and the Sevanagala Sugar Company which were established under the Revival of Underperforming Enterprises of Underutilized Assets Act No. 43 of 2011 are being operated as two operating units of Lanka Sugar (Pvt.) Company Ltd . The following observations are made with regard to the implementation of the main operations of this Company.

- (a) Although the total extent of cultivatable sugar cane area belonging to the Sevanagala Sugar Company was 4215 hectares, the total area of sugar cane cultivated lands were 3504 hectares in extent by the year 2017. Thus, even though the Company had had sufficient lands to obtain the supply of sugar cane required to maintain the factory operations at its maximum capacity, the Company had not taken actions to uplift the production of the factory by cultivating those lands.
- (b) The sugarcane yield obtained per hectare had been declined gradually whilst considering the 06 years period from the year 2012 to 2017 of the Sevenagala Sugar Company . Even though the sugar cane yield per hectare in the year 2016 was 86 metric tons, it had decreased to 69 metric tons by 2017. Nevertheless, the Company had not worked to improve this condition.
- (c) The content of sugar in the sugar cane used to produce sugar had declined from 11.23 per cent to 7.95 per metric ton in Pelwatte Sugar Company and from 7.95 per cent to 7.62 per metric ton Sevanagala Sugar Company from the year 2012 to 2017 respectively due to take long period to transport, factory disasters, litter and waste in sugar cane . Similarly, the percentage of sugar crushing in the sugar cane had declined from 8.95 to 7.3 per cent in Pelwatta Sugar Company and 8.01 to 7.67 per cent in Sevanagala Sugar Company from the year 2012 to 2017 respectively. However, the Company had not acted to prevent these situations.
- (d) Due to the decline in of sugarcane supply, out of 837,500 metric tons of sugar cane which was the maximum capacity of the Company 35 per cent had not been used during the year under review. Therefore, even though the sugar production of the Company was 51,422 MT in the previous year, it had dropped by 17 per cent to 42,841 MT in the year under review.
- (e) Even though the Ethanol production had declined from 11,917,279 bulk of liters to 7,045,228 liters by 41 per cent as compared to the previous year because of decrease in production of molasses which was the main ingredient in ethanol production due to declining sugar production during the year under review and the keeping in full of spirit storage tanks for a long period as a result of less number of ethanol sale.

- (f) Since the power generated using of disposable Bagasse had dropped from 16,346 MW hours to 12,534 MW hours due to the decline in the sugar production by the year under review as compared to the preceding year, even though the Company had to incur additional costs for alternative energy during the year under review , the Company had not taken steps to manage the situation.
- (g) Due to the, 29 tractors out of 43 tractors belonging to the Land Development Division had retained for more than six months in the agricultural workshop for repairs by the end of the year, though adversely affected to the production activities, the Company had not taken steps to repair the tractors immediately and use them for land development.
- (h) Due to the inability of the Management to provide the necessary equipment on time to prepare the lands for cultivation , the computed revenue which had lost to the Company was Rs. 409,950 per hectare.
- (i) In selecting fields for sugar cane harvesting, although the traditional system of the Company was the crushing of sugar cane samples which obtain from each field and sending to the factory laboratories and based on observations provided on the percentage of sugar extraction; the former General Manager had canceled the traditional method of sugar cane harvesting of the Pelwatte Sugar Company in the 2017 Maha season without obtaining the approval of the Board of Directors. Accordingly, the Manager of the Nucleus Estate had assured that the loss occurred to the Company was Rs . 159,559,000.
- (j) The crushing of sugar cane works had delayed by one month as the maintenance work that had to be completed before 31 March 2018 had not been completed by the end of April 2018 because of the considerable delays in the Purchasing Division for the purchase of necessary equipment with the objective of continuous operating with a view to carry out the maintenance on time in the Pelwatte Sugar Company which is more than 30 years old.

4.2 Management Activities

The following observations are made.

- (a) Out of a total of 104 incidents reported to the Investigation Division of the Pelwatte Sugar Company during the year under review, only 36 cases were completed. The Company had not taken actions to complete its investigation by recruiting adequate investigators.
- (b) The relevant information or any file on cases reported until the end of the year under review were not available at the institution at the instance of the examination carried out in the Legal Division and the Management had not taken actions to assign the duties properly to the Legal Officer who had recruited during the year under review and to organize the Legal Division properly.

- (c) The Carbon Dioxide Production Project of Sevanagala Sugar Company had been handed over to a private company in the year 2014 and the land, electricity, water and other infrastructure facilities required for this purpose were provided by the Company on free of charge. Similarly, without considering those matters, as the Company had allowed to that Company to sell the Carbon Dioxide less than even the market price of Rs. 25, although the Company had allowed to a private company to make profits up to 20 years using of the resources of the Company, the Management had not taken steps to revise those prices and to increase the revenue of the Company.
- (d) A contract valued at Rs. 27,067,812 had been awarded for the installation of Wastewater Treatment Plants in Sevanagala Sugar Company and although it was supposed to be completed by May 2014, because of the Management had not taken actions to complete it by the end of the year under review, the Company had failed to obtain an Environmental Protection License which should be obtained by the Factory.
- (e) When pumping fuel from the Fuel Dispensing Pump (electric) which was purchased for Rs. 479,808 in the year under review, since the issue is less than issued at the instance of issuing fuel, even though there was a surplus of 409 liters of Diesel as at 23 January 2018, the Company had not taken steps to repair the machine or provide a new fuel supply machine.
- (f) Out of the 66 Oxygen cylinders in the main warehouse of Sevanagala Sugar Company, 22 cylinders were missing and the Company had not carried out investigations and recover the losses from responsible officials.
- (g) The Acetylene cylinders remained at the warehouse of Sevanagala Sugar Company had been in excess of 10. Because of the Company did not maintain store books, these irregularities had occurred and the Company had not taken steps to manage the situation.
- (h) Due to poor internal control procedures of Sevanagala Sugar Company and missing of acetylene gas in the 26 acetylene cylinders of the year under review as well, the loss occurred to the Company was Rs. 78,185 . However, actions had not been taken by the Management to identify the officials responsible and recover the loss.
- (i) As per the Corporate Governance Guide "Appendix G", it has been described as the duties of the Company Secretary are maintaining the activities of Meetings on Board of Directors and the keeping of records. However, the Company Secretary had not been assigned such duties and another officer had been assigned to carry out these works.

4.3 Idle and Underutilized Assets

Since the supplier had not installed the Crane Machine purchased under lease for a cost of Rs. 128,910,000 in the year 2013 in the Company premises as agreed by the supplier, it was of no use from the date of purchased. The value of the lease installments and interest paid by the Company for this machine for the year under review was Rs. 21,734,748 and since

the total installment payable with interest for the next two years was Rs. 27,168,660 , this was observed as a futile expense.

4.4 Staff Administration

The Company had not taken actions to obtain an approved Scheme of Recruitment by the Department of Management Services and to identify the staff in specific and 08 management level officers were recruited on short term contract basis at the Head Office of the Company and these appointments had been extended repeatedly.

5. Accountability and Good Governance

5.1 Audit Committees

Despite an Audit Committee had been appointed by the Company, since the Board of Directors were not pointed out in the activities such as the preparation of financial statements according to Sri Lanka Accounting Standards, in the course of holding Annual General Meeting and sending Annual Reports to the Registrar of Companies, those activities had not been done on time .

5.2 Environmental Audit

The Wastewater Refining Unit of the Factory had not been completed even by the end of the year under review and the Company had not taken actions to minimize the environmental damage caused by releasing the wastewater into the environment.

5.3 Unresolved Audit Paragraphs

Failure to meet the costs incurred by the newly renovated club and guest house incurring a sum of Rs. 28,163,089 s per the Paragraph 4.1 (a) (i) of the Auditor General's Report for the year 2016 .

6. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Company from time to time. Special attention is needed in respect of the following areas of systems and controls.

Systems and Control Areas	Observations
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(a) Human Resource Management	Actions should be taken to prepare an

approved Scheme of Recruitment and recruit a specific staff.

(b) Procurement

Arrangements should be made to carry out procurement activities in accordance with the instructions of the Procurement Guidelines.