Northsea Limited - 2018

The audit of the financial statements of the Northsea Limited ("the Company") for the year ended 31 March 2018 comprising the statements of financial position as at 31 March 2018 and the statement of comprehensive income, 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 comments and observations which I consider should be tabled in Parliament in terms of Article 154(6) of the Democratic Socialist Republic of Sri Lanka, appear in this report.

1.2 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") is responsible for the preparation and fair presentation of the financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the Board 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 on 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 misstatements of the financial statements, whether due 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 Board, as well as evaluating the overall presentation of the 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 Basis for Qualified Opinion

The following observations are made.

(a) Opening balance adjustment amounting to Rs. 7,402,275 had been included in the income statements under other income. However, it had not been adjusted in cash flows statement.

(b) Due to calculation errors, depreciation on computers had been understated by Rs. 53,470 and depreciation on plant and machinery had been overstated by Rs. 419,250. As a result, profits for the year under review had understated by Rs. 365,780.

(c) Arrears payments of rents for the period from May 2016 to February 2017 amounting to Rs. 1,133,495, secretarial fees for the period from March 2015 to March 2017 amounting to Rs. 1,100,000, and electricity for the period from January 2016 to March 2017 amounting to Rs. 105,476 had been included in the financial statements as expenditure of the year under review. As a result, profits for the year under review had understated by Rs. 2,338,971.

(d) Interest on letter of credit and term loan interest for the previous year amounted to Rs. 226,895, and Rs. 487,693 respectively had been stated as financial expenses of the year under review. As a result, profits for the year under review had understated by Rs. 714,588.

(e) A provision for accrued interest on term loans for the month of March 2018 amounting to Rs. 362,227 had not been included in the financial statements. As a result, profits for the year under review had overstated by similar amount.

2 Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 March 2018, and its financial performance and its cash flows for the reporting period then ended in accordance with Sri Lanka Accounting Standards.

2.2 Report on Other Legal and Regulatory Requirements

As required by Section 163(2) of the Companies Act No. 07 of 2007, I state the followings. The basis of opinion and scope and limitations of the audit are as stated above. In my opinion:

- Except for the matters described in Basis for Qualified Opinion paragraph, I have obtained all the information and explanations that were 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 requirements of Section 151 of the Companies Act, No. 07 of 2007.

2.3 Accounts Receivable and Payable

2.3.1 Receivables

The following observations are made.

(a) In respect of machinery spare parts amounting to Rs. 1,234,000 returned by the Company had been shown in the financial statements as receivables. However, according to the balance confirmation received from the supplier, no any outstanding balance payable to Northsea Ltd and the management had been failed to take measure to reconcile the balance.

(b) According to the age analysis of debtors, a sum of Rs. 4,833,760 had been remained for several years without being reconciled. However, the management had been failed to reconcile such balances.

2.3.2 Payables

The following observations are made.

(a) Three creditors aggregating to Rs. 8,246,426 had remained without been settled for over one year.

(b) Proper actions had not been taken to settle statutory payments in time, As a result, at the end of the year under review statutory payment an aggregating to Rs. 164,564,529 had remained without being settled over one year.

2.4 Accounts set-off without Approval

Payable balance amounting to Rs. 17,326,782 had been set-off against the receivable balance without any approval.

3. Financial Review

3.1 Financial Results

The following observations are made.

(a) According to the financial statements of the year under review, the profit for the year was Rs. 5,369,442 compared to the loss of Rs. 61,111,357 of the previous year which shows a 109 per cents growth and it was mainly due to the increase in sales by Rs. 122,870,791 during the year.

(b) Further, current liabilities of the Company exceeded its total current assets by Rs. 206,468,023. Accordingly, it shows that the Company's liquidity position is unfavorable.

3.2 Cash Management

A system for banking daily cash collections had not been properly implemented. As a result, a sum of Rs. 2,644,180 was remained hand without deposited in the bank as at the end of the year under review.

3.3 Analytical Financial Review

The current ratio at the end of the year under review was 0.5 when compared the 0.36 of the previous year. Accordingly, it was revealed that the ratio between the Company's current assets and current liabilities are not in acceptable level.

4 Operational Review

4.1 Management Inefficiencies

The closing stocks of Lunuwila factory had included non-moving stock items amounting to Rs. 696,076 and slow-moving items amounting to Rs. 1,893,342. However, the Company had not taken adequate measure to sell those items within a reasonable period of time.

4.2 Operational Inefficiencies

The following observations are made.

(a) Raw materials imported by the Company had been transport from Colombo to Jaffna factory and then transport from Jaffna to Lunuwila and Weerawila factories, instead of being transport directly to Lunuwila factory though it was close to Colombo. As a result, the Company had incurred additional cost for transportation due to inefficient practice in transportation.

(b) In 83 instances sold fishing nets aggregating to Rs. 448,947 had been returned during the year under review. However, details of actions taken by the Company to rectify the situation were not made available to audit.

4.3 Unauthorized Transaction

The following observations are made.

(a) Even though one person cannot hold the positions of Executive Director and the Secretary of the Company, the Executive Director of the Company had been working as the Company's Secretary while working as an Executive Director. Further, without obtaining the approval from the Department of Management Service (DMS) according to its letter No. DMS/1747 dated 29 December 2017. A sum of Rs. 1,392,000 had been paid by the Company to the Executive Director for working as the Company's Secretary.

(b) A sum of Rs. 13,425,486 had been charged by the Company as administrative expenses from the livelihood project without being obtained proper approval from the relevant Ministry.

4.4 Assets Management

The following observations are made.

(a) The Company had not transferred the ownership of lands in Weerawila factory and Lunuwila factory.

(b) The Company had been used five vehicles without get transferred the ownership of vehicle to the Company.

4.5 Idle or Underutilized Property, Plant and Equipment

The following observations are made.

(a) Book value of a vehicle amounting to Rs. 300,000 had been included in the motor vehicle account of the Central Office, Even though it had not been used by the Central Office. Further, that vehicle is not in running condition and parked in Lunuwila factory.

(b) Nine machines valued at Rs. 21,052,082 had not been used by the Lunuwila factory in optimum capacity for long period due to some technical errors. As a result, the cost per unit of production had increased due to wastage of electricity and idles of labour hours since machineries are idle in the process of the production. Further, management of the Company had been failed to rectify the situation for a long period.

(c) Two low ply twisting machines, installed in Lunuwila factory had not been used for production of twine even if those are in working condition and other resources including raw material and labour are available, those machines could be used for the production in other factories of the Company. However, the management of the Company had not taken proper actions to use such assets by transferring to other factories to get maximum benefits.

4.6 Utilization of Assets of Other Organizations

The following observations are made.

(a) A motor car owned by the line Ministry, had been used by the Central Office of the Company for long period. However, necessary actions had not been taken by the Company to transfer the ownership of the vehicle and to account the value of the vehicle accordingly.

(b) Jaffna and Weerawila factories had been using seven vehicles owned by other Government Institution for long period. However, only the value of two vehicles amounting to Rs. 356,615 had been recorded in the books of accounts of the Company.

4.7 Procurement Management

The following observations are made.

(a) As per the Procurement Guidelines, every entity should prepare a master procurement plan at least for a period of three years and a procurement activities plan for the immediate succeeding year in detail. However, the Company had prepared a procurement plan relating to resettlement activities only.

(b) As per the Procurement Guidelines, the Company should have carried out initial need assessment prior to procure goods or services. However, the Company had procured a steam boiler at a cost of Rs. 3,387,109 on 02 November 2017 for the use of Weerawila factory without being carried out any feasibility study or environment examination. As a result, the Company had been failed to utilize the steam boiler for more than 6 months period due to lack of space to install the steam boiler.

5 Accountability and Good Governance

5.1 Effectiveness of Management Information System

The following observations are made.

(a) According to the inventory management system of the Company, cheque print facilities are available in the AccSsoft ERP system. However, the Company without use that facility, the Company had used to write cheques manually.

(b) Even though, approval procedures for every transaction are available in the ERP system. However, approval for all transactions had been given by one management assistant who is responsible for recording the same transactions. According, audit observed that there are risks of fraud due to the weaknesses in internal control system.

(c) Even though, fixed asset modules are available in AccSsoft ERP system, the Company had maintained a fixed asset register manually. Further, the cost of the assets, procured date, type of assets, details of disposal, etc. had not been included in the asset register.

(d) All three factories are used the same ERP system to maintain accounts separately. However, the Company had not used that system to integrate the accounts of branches and factories with the head office accounts. Further, the Company had been failed to properly implement the VPN connection facility provided by the AccSsoft ERP system.

(e) The Company had not designed and maintained proper accounts codes in general ledger. As a result, the Company had been failed to prepare the amalgamated accounts through the system.

(f) Access rights for the system had not been properly provided to employees through the system by delegating authorities. Instead, the entire user IDs had been assigned to one management assistant by the administrator without being considered the management responsibility for internal control system.

5.2 Internal Audit and Audit & Management Committee

In terms of Department of Management Audit Circular No. DMA/cir-edit/2016 dated 28 January 2016, the Company should conduct at least 6 Audit and Management Committee Meetings per year. However, the Company had conduct only one Audit and Management Committee Meeting during the year under review. Further, the internal auditor had not carried out internal audit to evaluate the internal control system of the Company.