Maganeguma Emulsion Production Company (pvt) Ltd. - 2018

1 Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the Maganeguma Emulsion Production Company (PVT) Ltd ("Company") for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 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 report to Parliament appear in this report.

In my opinion, except for the effects of the matters described in paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Qualified Opinion

My opinion is qualified on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

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 Audit Scope

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

  The scope of the audit also extended to examine as far as possible and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;

- Whether the Company has performed according to its powers, functions and duties; and

- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Non-Compliance with the Sri Lanka Accounting Standards

Non-Compliance with the reference to particular Standard		Management Comment	Recommendation
(i)	As per Sri Lanka Accounting Standard on property, plant & Equipment (LKAS 16), the assets of which fully depreciated with the costs amounting to Rs.21, 566,870 are being used by the company had not been reviewed its useful life time at the end of each financial year and accounted accordingly.	Accepted. Recommendation will be implemented from the year 2021	As per the relevant accounting standard, the company should review the useful life time of property, plant & Equipment at the end of each financial year and accounted accordingly.
(ii)	Contrary to the Sri Lanka Accounting Standards on presentation of financial statements (LKAS 01) and conceptual frame work for financial reporting, the Interest income on fixed deposits of the Company had been measured by using cash basis and the audit observed a difference of Rs.8, 654,795 in interest income between interest income calculated by the audit and the interest income show in the financial statements. As a result, other income shown in the statement of comprehensive income had been overstated by the similar amount.	It will be very difficult to recognize the interest income on accrued basis	The Interest income on fixed deposits of the Company should measure on accrual basis.
(iii)	Contrary to the Sri Lanka Accounting Standards on Presentation of Financial Statements (LKAS 01) & leases, (LKAS 17) liabilities should separately classified as current and non-current liabilities. However, as per the financial statements of the Company, the total lease creditors amounting to Rs. 2,090,060 as at 31 December 2018 had not been classified accordingly.	Accepted and agreed to rectify.	Liabilities on leases should separately classify as Current and Non-Current as per prescribed in relevant accounting standard.

1.5.2 Accounting Policies

Audit Issue	Management Comment	Recommendation
The Company had been calculated the retirement gratuity obligation by multiplying the period of service by monthly salary earned by each employee instead of calculating by using half month salary.	As the Policy of company one-month basic salary is used for provision and payment of the gratuity by multiplying the completed period of service.	When the company is constructed an accounting policies, should consider the existing laws, rules and regulations and standard requirements relating to the subject matter.

1.5.3 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(i)	Cost of Computer Software of Rs. 246,180 had not been included under the intangible assets in the financial statement of the year under review. As a result, the cost of non-current assets had been understated by similar amount.	Computer software is fully amortized and non-useable. Therefore, the Intangible assets are removed from the Financial Statements.	Cost of assets should not remove from the assets of the company until those assets are disposed.
(ii)	As per the audited financial statements the cost of the property plant & equipment as at 31 December 2017 was Rs. 38,077,577. However, as per the financial statements of the year under review, the opening balance of the property plant & equipment as at 01 January 2018 was Rs. 39,359,792. Hence, difference of Rs. 1,282,215 was observed in opening balance.	"Fully Depreciated Assets" were classified separately of the financial statements in 2017 and were taken back into the Property Plant & Equipment in 2018.	It is not required disclose fully depreciated assets in the financial statements.
(iii)	As per the Note 4 to the financial statements of the Company, the capital investment from the Road Development Authority to the Company was only Rs.100. However, as per the financial statement of the Authority, an investment of Rs.1, 000, 000 had also been included as an equity contribution to the Company in addition to Rs.100. However, the Company had been recorded the subsequent investment made by the Authority as an unpaid loan under the current liability.	Unpaid loan balance is the amount due from RDA which is agreed to give in the establishment of this company.	An agreement is required to record transactions occurred within the group especially on the transactions that are being decided the controlling power of the company.

1.5.4 Un-reconciled Control Accounts or Records

Item	As per Financial Statements (Rs.)	As per corresponding Record (Rs.)	Difference (Rs.)	Management Comment	Recommendation
Difference between the total amount of Property, Plant and Equipment shown in the financial statements and the schedules related to it.	39,420,400	38, 077,577	1,096,643	Accepted and schedule will be corrected.	Actions should be taken to reconcile the difference identified.
A difference was observed as at 31 December on the amount which due from Road Development Authority to the company.	5,861,611	2,428,542	3,433,069	The balance in the financial statements of the company is correct balance.	A reconciliation statement should be prepared periodically.
A Difference was observed between the amounts due to the RDA from the company as at 31 December 2018.	1,471,358	4,456,625	3,985,267	The financial statements balance is correct balance.	A reconciliation statement should be prepared periodically.

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 2.1 of the Public Enterprises Circular No. PED 3/2015 dated 17 June 2015	Contrary to the entitled limits, the Company had been paid sitting allowances aggregating to Rs. 198,000 to the non-executive directors during the year under review.	It is stated the Board of Directors has approved this payment.	The company should adhere to the existing frame work and guidelines issued by the respective authorities in making such payments and the RDA also should prescribe the guidelines as the parent entity through its board representatives.

(ii)	Section 3.1 of the public Enterprises Circular No. PED 01/2015 date 25 May 2015.	Contrary to the entitle limits, fuel allowances aggregating to Rs.1,047,150 had been paid exceeding the entitle limit.	This allowance has approved by the Board of the Directors of the company.	The company should adhere to the existing frame work and guidelines issued by the respective authorities in making such payments and the RDA also should prescribe the guidelines as the parent entity through its board representatives.
(iii)	Public Enterprises Circular PED/12 dated 2 June 2003			
(a)	Section 5.2 of the Circular.	An annual budget had not been prepared by the Company.	Accepted and agreed to prepared a report for the following year.	An annual budget should be prepared in accordance with the circular.
(b)	Section 7.4 of the Circular	Audit Committee had not been established to ensure the decisions for effective operations of the Company.	Accepted and agreed to rectify.	Audit Committee should be established with immediate effect in accordance with the circular.
(c)	Section 9.2 and 9.3 of the Circular	The company had not been taken an action to get the approval done for the cadre as well as the recruitment and promotions system.	An approved Human Resources Manual is available including all the relevant procedures.	An approval for the cadre and the recruitment and promotions system should be obtained from the relevant authorities.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs. 75,746,974 and the corresponding loss in the preceding year amounted to Rs. 77,899,167. Therefore an improvement of operating result amounting to Rs.2,152,193 of the financial result was observed. The main reason for the improvement of the operating result is increase the sales income by 50 percent compared with the preceding year.

2.3 Ratio Analysis

	2018	2017
Current Assets Ratio	**1.63**	**2**
Quick Ratio	**1.29**	**1.53**
Gross Profit Ratio	**4.9**	**(5.4)**
Net Profit Ratio on PBT	**(91.67)**	**(134.68)**

As per the Current Assets Ratio calculated, it is observed that the company had been maintained within the acceptable range and Quick Assets ratio is also maintained by the company within the Acceptable range for the year under review.

Gross profit ratio had been increased by 10.3 percent while Net profit ratio was being increased by almost 43 Percent. It is observed that a significant increment of sales by Rs.50 percent over the increment of costs of goods sold by 35 percent was the main reason for such increment of the annual profitability.

3. Accountability and Good Governance

3.1 Submission of Financial Statements

Audit Issue	Management Comment	Recommendation
Submission of financial statements of the company delayed in almost two years from the due date.	No comment	Financial Statement should be submitted on due date to the Auditor General.

3.2 Internal Audit

Audit Issue	Management Comment	Recommendation
An internal Audit Unit for the company had not been Established.	Not prepared for the year 2019	An Internal Audit Unit for the company should be established in the company.

3.3 Audit Committee

Audit Issue	Management Comment	Recommendation
Audit and management committee had not been established by the company with the concurrent of the line Ministry and the Road Development Authority.	Noted and an action will be taken	Audit and management committee should be established.