Lanka Sathosa Limited - 2018

1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the Lanka Sathosa Limited ("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.

I do not express an opinion on the accompanying financial statements of the Company. Because of the significance of the matters discussed in the Basis for Disclaimer of Opinion section of my 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

My opinion is Disclaimed base 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.

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 skepticism 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 Audit Observations on the preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(a) According to paragraphs 80 and 81 of the Sri Lanka Accounting Standards 12, income tax expenditure / losses had not been disclosed by notes to the financial statements.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Action should be taken in accordance with the Sri Lanka Accounting Standards.
(b) The Company had not followed the Sri Lanka Accounting Standards 2 when valuing the stocks. Various errors such as inherent internal errors, data omissions, errors in double entries, and over and under value entries were observed due to the manual accounting system in the 3/4 of the island-wide outlets network. Accordingly, It could not be determined or quantified the potential financial impact of the inventory value of Rs.4,462,675,947 to the financial statements regarding the cost of sales and the current assets.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Action should be taken in accordance with the Sri Lanka Accounting Standards.
(c) Although fully depreciated property, plants and equipment currently used in operation should be revalued and disclosed in the financial statements at a fair value as per the Sri Lanka Accounting Standards 13, property, plants and equipment amounting to Rs.135,482,188 had not been done in the manner.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Action should be taken in accordance with the Sri Lanka Accounting Standards.

1.5.2 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
(a) Total Depreciation of Rs.14,418,141 comprising Rs.9,078,568 for nameplates and fittings, Rs.5,022,286 for computer software related hardware, Rs.308,537 for computer equipment and Rs.8,750 for buildings had not been accounted and as a result loss for the year had been understated and the property, plant and equipment had been overstated.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Depreciation must be accurately calculated and accounted for.
(b) Unidentified opening balances of property, plant and equipment totaling of Rs.504,367,279 as at 31 December for the year under review remains from the year 2013, comprising with Rs.45,783,758 of buildings, Rs.108,811,186 of computer equipment, Rs.1,111,247 of computer software related hardware and Rs.348,661,088 of office equipment.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Unidentified balances in the initial balances should be identified and accounted for.
(c) The amortization for the new addition to the computer system identified as intangible assets in the financial statements had been overstated by Rs.1,374,950 and networking and licenses had been understated by Rs.157,424 and Rs.122,425 respectively and as such the loss for the year had been overstated by Rs.1,095,101.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Amortization on the intangible assets must be accurately calculated and accounted for.

1.5.3 Unreconciled Control Accounts or Records

Item	As per Financial Statements	As per corresponding Record	Difference	Management Comment	Recommendation
	Rs.	Rs.	Rs.		
(a) Trade Receivable Account	23,916,925	29,317,750	5,400,775	There was only agreement on the audit paragraph and the action to be taken was not stated.	The reason for differences between ledger accounts, control accounts and financial statements should be examined and corrected.
(b) Credit Memo Control Account	67,067,996	63,163,488	3,904,508		

1.5.4 Going Concern of the Organization

Audit Issue	Management Comment	Recommendation
At the end of the year under review the company had reported accumulated deficit of Rs.14,742,629,777 as well as current liabilities over current assets of Rs.2,560,855,506 and as a result the company's ability to meet its liability and to continue without the treasury provisions is in doubt. Trade payable and other debt balances amounting to Rs.6,902,618,157 were the main reason for this situation.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Action should be taken to maximize the profit through managing assets efficiently and engaged in operating efficiently.

1.5.5 Documentary Evidences not made available for Audit

Item	Amount Rs.	Evidence not available	Management Comment	Recommendation
(a) Property, Plant and Equipment				
(i)	201,720,211	Documents confirming the ownership of the company in relation to the buildings.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Documents confirming the ownership of the relevant assets should be maintained.
(ii)	22,798,843	Schedules for assets acquired by the cooperative wholesale corporation		
(iii)		Documents confirming the ownership of 20 perches land where a commercial building was constructed in Mannar area.		
(b) Amortization (i) Trade Loan Receivable Control Account balance	62,959,958	Although provision had been made for impairment from the year 2015, the approval obtained for it, the relevant schedules and the age analysis of the debtors.		Approval should be obtained for amortization and schedules for amortization and debtor age analysis should be maintained.

(ii)Gondola Income Balance	92,000			
(iii)Balance Receivable from CWE	10,083,353			
(iv)Balance due from Ministry of Sports	36,453,533			
(v)Festival Advance	446,000			
(vi)Import Realization Advance	267,600,500			
(vii) Big Anion Control	137,826,385			
(viii) Remittance	56,762,337			
(ix) Deposit for Containers	19,507,254			
(b) Income Tax	10,927,534	Written evidence for confirmation and approval for the provisions for the removal made against the balances due thereon.		Documents confirming the relevant assets should be maintained.
(c) With Holding Tax	2,005,410			
(d) Gondola Income Receivable Account	6,683,193	Age Analysis.		Updated age analysis should be maintained.
(e) Receivable Balance	113,154,762	Balance Confirmation		Balance confirmation procedure should be managed.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
The age analysis of the debtors could not be accurately identified during the audit as all the balances of the receivable accounts as at end of the year under review amounting to Rs.121,297,830 included in the category of more than 90 days according to the age analysis. Further, the total balance of debtors in that account for more than one year was Rs.23,793,702, out of this, over one million balances related to 4 debtors amounted to Rs.18,337,845 and Rs.4,661,900 recoverable from one debtor older than 2 years included in above balance.	There was only agreement on the audit paragraph and the action to be taken was not stated.	The age of the debtors should be analyzed and action should be taken to recover.

1.6.2 Payables

Audit Issue	Management Comment	Recommendation
(a) Trade payable balance Rs.2,764,346,616 as stated in the financial statements out of this balance, a sum of Rs.55,802,049 was confirmed by the suppliers and the unconfirmed balance was Rs.2,708,562,567. Further, the suppliers of Rs.1,385,265,338 had not responded to the confirmation called from the balance of Rs.4,149,611,955.	All balance inquiries have been referred to the relevant parties and that it is not the company's responsibility for not sending balance confirmation to the audit by the suppliers.	Internal controls need to be strengthened and balances should be reassessed. Unconfirmed credit balances should be monitored.
(b) Accuracy of the balance in credit and debit control account could not be ascertained as bank confirmation of balances of Bank of Ceylon, Commercial Bank and Nations Trust Bank amounting to Rs.4,088,416, Rs.8,449,307 and Rs.2,084,426 respectively related to the above account had not been submitted for audit. Further, account balance of the Hatton National Bank related to the above accounts was Rs.4,128,826 and bank confirmation at the end of the year under review was Rs.5,862,238 and therefore there was a difference of Rs.1,733,412 between those balances.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Internal controls need to be strengthened related to the balances of credit and debit control account and balances should be reassessed.

(c) Action had not been taken to obtain balance confirmations from relevant parties of the rental advance balance of Rs.209,351,446 and rent deposit balance of Rs.5,532,120 stated in the financial statements for the year under review.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Internal controls need to be strengthened related to the rental advance balance and rent deposit and balances should be reassessed.

1.7 Related Parties and Related Party Transactions not disclosed

Audit Issue	Management Comment	Recommendation
As stated in Note 29.2 of the Financial Statements, independent confirmations had not been received regarding the balances of the related parties and as a result the accuracy and completeness of the declared balances could not be satisfied.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Internal controls need to be strengthened to identify the related parties.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
Public Enterprise Circular No. PED/57 of 11 February 2011			
(i) Paragraph 2	A sum of Rs.82,784,960 had been spent on advertising during the year under review without obtaining the approval of the Department of Public Enterprises on the an annual advertising programme prepared in line with the Annual Action Plan.	There was only agreement on the audit paragraph and the action to be taken was not stated.	An annual advertising programme should be prepared and obtained approval from the Department of Public Enterprises.
(ii) Paragraph 6	Although the approval of the Minister of Finance was required for advertisement expenses not incurred in the Annual Advertising Program, in the absent of the annual advertisement programme a sum of rs.6,700,000 had been spent without approval of the Minister of Finance on the	There was only agreement on the audit paragraph and the action to be taken was not stated.	Approval of the Minister of Finance should be obtained for expenditure on advertising activities which are not included in the approved annual advertising program.

	brand name advertised in the two series played by the Sri Lanka Cricket team.		
(b) Section 9.7 of the Public Enterprise Circular No. PED 12 of 02 June 2003	A performance allowance of Rs.250,000 had been paid to the chief executive officer with the approval of the board of directors, without approval of the treasury and Rs.7,275,000 had been paid to 8 deputy general managers Rs.75,000 each per month during the year under review without approval of the board of directors.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Treasury approval should be obtained when paying allowances.
(d) Management Services Circular No. 2017/05 of 25 October 2017	Although a professional allowance could be paid to senior level officers of state-owned companies on the basis of length of service, on the contrary, the senior officers of the company were paid an additional Rs.693,000 as professional allowance during the year under review.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Payments should be made according to the circular.
(e) Public Enterprise Circular No. 2015/1 of 25 May 2015	Although the officers who are entitled to use the official vehicles for his official and personal use can be availed an official vehicle or monthly transport allowance, contrary to this, without approval of the treasury, transport allowance of Rs.1,885,833 at the rate of Rs.12,500 per month for each officers had been paid by the company to the 17 officers who are not entitled to use the official vehicles during the year under review.	There was only agreement on the audit paragraph and the action to be taken was not stated.	should act according to the circular.

(f)	Letter of the Director General of Management Services No. DMS / 1741 of 16 May 2017	In the relevant letter, the Department of Management Services has approved the monthly allowance to be paid to the chief executive officer and deputy general managers of Rs.95,000 and Rs.90,000 respectively, but with the approval of the board of directors, a monthly allowance of Rs.250,000 paid to the chief executive officer and without the approval of board of directors a monthly allowance of Rs.150,000 paid to the deputy general managers. Accordingly, the overpayment to 07 officers during the year under review without the approval of the Treasury was Rs.5,100,000.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Treasury approval should be obtained for all allowances paid in addition to the approved salary.
(g)	Letter from the Director General of Management Services, DMS / 1744 dated 22 February 2017	For the post of Deputy General Manager (Marketing) recruited during the year under review, a sum of Rs.1,299,753 had been paid for performance, transport, fuel and telephone allowances in excess of the approved monthly allowance of Rs.150,000.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Treasury approval should be obtained for all allowances paid in addition to the approved salary.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a deficit of Rs.2,918,933,655 and the corresponding deficit in the preceding year amounted to Rs.2,782,828,920. Therefore an deterioration amounting to Rs.136,104,735 of the financial result was observed. The reasons for the deterioration was mainly due to increased wages and allowances.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
(a) According to the instruction given by the Department of Labour, following an inspection of the Company's Employees' Provident Fund contribution calculation, revised the employee's contribution to the Employees' Provident Fund from 10 percent to 8 percent from January 2018 and over charged amount of Rs.5,550,876 equal 2 percent from the employees for the month of January 2018 and credited to the Employees' Provident Fund. This amount had been added back to the employee's salary in February 2018.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Contributions paid to the employee due to the amendment should be recovered from the employee.
(b) Due to the calculation of the employer's contribution to the Employees Provident Fund and Employees Trust Fund in January 2018 based on the gross salary including all allowances, a sum of Rs.5,827,217 had been over paid in the manner of Rs.4,461,774 to the Employees Provident Fund and Rs.1,165,443 to the Employees Trust Fund.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Should be charged from the responsible parties.

3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Although an advance of Rs.9,175,000 had been paid to obtain 19 buildings on the rent basis in the years 2015, 2016, 2017 and 2018 to open the Sathosa outlets, no action had been taken to open those outlets by the date of audit. Seven outlets relevant to rent advance payment of Rs.10,605,000 had been opened after considerable time lapsed from the agreed date and action had not been taken to enter the agreement with the building owners relevant to unopened 12 outlets.	There was only agreement on the audit paragraph and the action to be taken was not stated.	When renting a building, lease agreements should be entered into and advances should be paid in accordance with the agreement. Arrangements should be made to open shops during the agreed period.

	Further, a sum of Rs.3,276,380 had been paid as rent deposit for 11 buildings belonging to the government institutions which were obtained on rent basis without a formal lease agreement.		
(b)	The Company had obtained a loan of Rs.14,174,576,124 from State Banks through opening letters of credit for the importation of rice in the years 2014 and 2015 and by the date of 31 of December 2018, the loan amount and interest of Rs.10,485,627,819 had to be repaid. Also, the company had obtained a loan of Rs,3,000,000,000 from another state bank to evade the working capital issues that company faced due to importing of rice through loans and a sum of Rs.1,915,895,507 as loan installment and interest to be paid. However, Cabinet approval was obtained on 04 March 2020 to settle the amount due by the Treasury in respect of loans obtained for the importation of rice. and no action had been taken to settle the amount as at the date of this report.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Loan should be settled according to the approval of the Cabinet.
(c)	The advance amount of Rs.14,108,445 paid to Sathosa Construction and Engineering Pvt. Ltd. in 2017 for the construction of a commercial building in the Mannar area had been shown in the financial statements as work-in-progress and the relevant constructions that had been halted due to a court action had not been resumed by the date of this report.	There was only agreement on the audit paragraph and the action to be taken was not stated.	Construction should be resumed with proper management.