Kalubowitiyana Tea Factory Company Limited -2020/2021

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the Kalubowitiyana Tea Factory Company Limited ("Company") for the year ended 31 March 2021 comprising the statement of financial position as at 31 March 2021 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 March 2021, 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 (Auditor's Responsibilities for the Audit of the Financial Statements)

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 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)	Accordance to the Sri Lanka Accounting Standards No. 07, although the acquisition of Biological Assets amounting to Rs. 1,333,382 should be shown under investment activities in the cash flow statement, it had erroneously stated its annual depreciated value of Rs.1,228,538 as asset acquisition under investment activities.	The net value of acquisition of Biological Assets valued at Rs.1,228,538 had been stated under investment activities of the cash flow in preparing the cash flow. The net value is shown in the preparation of the cash flow statement for the financial years 2018/2019 and 2019/2020 and According to the consistency concept, the net value had been included in the cash flow statement in this year as well.	The cash flow statement should be prepared in accordance with Sri Lanka Accounting Standards.
(b)	Although a tax payment or refund had not been done for the year under review, an income tax receipt of Rs.4,162,195 was stated in the cash flow statement.	Noted. Corrections will be made in the future.	The cash flow statement should be prepared in accordance with Sri Lanka Accounting Standards.
(c)	Accordance to the paragraph 51 of the Sri Lanka Accounting Standards No. 16, the assets such as plant and equipment, furniture and fittings, office	As pointed out in the audit of the year 2016/2017 by the letter dated 13.12.2017, the Valuation	The effective life of the assets should be re-valued and accounted in accordance with Sri

	equipment and motor vehicles which were fully depreciated by the year 2018 amounting to Rs.240,350,688 were still being used due to an annual review of the effective life of non-current assets had not been conducted. The action had not been taken to rectify those estimated errors in accordance with Sri Lanka Accounting Standard No. 08 and show the accurate carrying value in the financial statements.	Department had been informed to assess the immovable and movable assets of the institution. As per our request, the relevant assets were valued and 32 assessment reports were issued regarding the assets of the four factories. The relevant inspections had been carried out by the Valuation Officers by coming to the head office to assess the assets and valuation reports were obtained and plans were made for future activities.	Lanka Accounting Standards.
(d)	The lands of Kalubowitiyana and Derangala factories acquired in 1994 at a total cost of Rs.2,550,000 had not been revalued and taken into financial statements as per paragraph 34 of the Sri Lanka Accounting Standard No.16.	The assessment report had not been obtained yet regarding the lands where the Kalubowitiyana and Derangala factories are located and action will be taken to obtain the assessment reports expeditiously as per the audit report.	Land should be revalued and the value should be accounted in according to Sri Lanka Accounting Standards No.16.

1.5.2 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(a)	Although the bank loan interest expense for the year under review was Rs.1,674,073, it had been accounted as Rs.1,298,624 by less amount of Rs.375,450.	Noted and action will be taken to rectify in the future.	All transactions must be properly accounted for without leaving.
(b)	The value of other creditors was Rs.8,875,372 as per the financial statements and Rs.8,682,151 as per the schedule. Thus it was observed an un-reconciled difference of Rs.193,221.	Corrected. The schedules are attached herewith.	It should be confirmed that the ledger balances are the same as schedules in preparing financial statements.
(c)	According to the Section 14 (1) of the Employees Provident Fund Act No.15 of 1958, although the cost of living allowance should be added to the basic salary and the provident fund contribution should be calculated on that earnings, the outstanding contribution to the provident fund from the year 2012/2013 to the year 2017/2018 was Rs.1,695,177 due to the calculation of the provident fund contribution by the company irrespective of the cost of living allowance and it was also observed that the surcharge to be paid on that was Rs.847,589. The company had not made any provision for this expenditure in the financial statements for the year under review.	The amount should be credited to the Provident Fund due to calculating the Provident Fund without considering the cost of living allowance since 2012/2013 will be credited as soon as the financial position of the company improves.	The provident fund contribution should be calculated and as per Section 14 (1) of the Employees Provident Fund Act No. 15 of 1958.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

	Audit Issue	Management Comment	Recommendation
(a)	A sum of Rs.1,408,881 was stated as other advances under pre-paid expenditure and other receivables and according to the schedule submitted for audit, these balances were the balances on transactions from 2014 to 2018. These long outstanding balances are observed in the audit as contentious items.	It will be submitted to the Audit Committee and action will be taken to rectify it in the future as it is long outstanding balance.	It should be recovered from the responsible officers of the Board or the relevant institutions.
(b)	Although it had been stated in the balance confirmation letters of the previous year and the year under review that there is no payment due from the Giragama Estate owned by the Pussella Plantation Company, a sum of Rs.1,046,771 had been stated as a balance due from that company in the financial statements of the year under review.	It will be submitted to the Audit Committee and action will be taken to rectify it in the future as it is a long outstanding balance.	Balance receivables should be compared with the balance confirmation letters of the Giragama Estate and adjustments should be made in the financial statements.
(c)	Although a loan of Rs.10,000,000 at an interest rate of 22 per cent had been given to BCC Lanka Limited in the year 2003 on the basis of recovery by 12 installments, any installment could not be recovered out of it. Therefore, the loan and interest receivable at the end of the year under review were Rs.58,382,429.	Monthly remind letters regarding the loan and the interest thereon had been issued to the BCC Lanka and it is expected to be able to recover in the future.	Action should be taken to recover the loan amount and the interest thereon immediately.

(d)	A sum of Rs.798,461 due from a private tea broker company was being carried forward since 2009 and action had not been taken to recover it until at the audit date.	It will be submitted to the Audit Committee and action will be taken to rectify it in the future as it is a long outstanding balance.	Action should be taken to recover the relevant amount or to write it off in the books with proper approval.

1.6.2 Payables

	Audit Issue	Management Comment	Recommendation
(a)	A sum of Rs.3,710,375 was accounted as a balance due to the Tea Shahthi Fund and two other private companies for more than four years and the action had not been taken to settle by the end of the year under review. It seems to be controversial as these institutions had not claimed this money.	Corrections will be made in the future.	Steps should be taken to correctly identify the parties to the payment and settle immediately or to credit to the revenue by ensuring that claims did not further arise.
(b)	The Cheques returns and pay-as-you-earn surcharges for more than four years are Rs.843,158 and Rs.59,344 respectively has been included in the accrued expenditure account and the action had not been taken to settle even as at end of the year under review.	Corrections will be made in the future.	Steps should be taken to settle immediately.
(c)	The balances payable to trade creditors amounting to Rs.1,582,797 are being carried forward for more than four years still remain unchanged and the action had not been taken to settle them by the end of the year under review.	Action will be taken in the future to rectify as it is the long outstanding balances.	Steps should be taken to correctly identify the parties to the payment and settle immediately or to credit to the revenue by ensuring that claims did not further arise.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a) Public Enterprises Circular No. PED / 12 dated 02 June 2003			
(i) Section 8.2.2	Although the approval of the Minister of Finance and the relevant Minister should be obtained when investing funds, the Company had invested Rs.159,454,572 in short-term deposits as at 31 March 2021 but the necessary approvals had not been obtained accordingly.	Action will be taken to obtain the required approvals in the future.	The approval of the relevant Minister and the Minister of Finance should be obtained as per Section 8.2.2 of the Circular.
(ii) Section 9.1.4	Although a Procedure Manual for the formulation of rules and regulations for human resource management should be prepared, and approved by the Secretary to the Treasury, the company had not acted accordingly.	Actions are being made to prepare a Procedure Manual for the formulation of rules and regulations for human resource management.	A Procedure Manual should be prepared immediately and relevant approval should be obtained.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a deficit of Rs. 15,144,959 and the corresponding surplus in the preceding year amounted to Rs. 43,267,577. Therefore a deterioration amounting to Rs. 58,412,536 of the financial result was observed. The reasons for this deterioration were mainly due to the increase in production cost by Rs. 54,989,023 compared to the previous year and the decrease in financial income by Rs. 3,215,607.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review compared with the preceding year are given below.

Item	2020/2021	2019/2020	Difference	Variance Favorable/Unfavorable
	Rs.	Rs.	Rs.	%
Income				
Sales Income	1,175,716,247	937,789,275	237,926,972	25
Cost of Sales	1,158,860,303	845,680,913	313,179,390	37
Other Operating Income	15,240,381	7,201,626	8,038,755	112
Financial Income	11,508,748	14,724,355	(3,215,607)	(22)
Expenditure				
Administrative Expenditure	43,913,954	50,712,395	(6,798,440)	(13)
Sales and Distribution Expenditure	646,594.64	400,677	245,917	61
Financial Expenditure	14,189,483	19,653,695	(5,464,211)	(28)

Although sales revenue had increased by 25 per cent compared to the previous year, the company had shown a significant loss for the year under review due to a 37 per cent increase in the cost of sales. The financial income also declined by 22 per cent compared with the previous year.

2.3 Ratio Analysis

Although the Current Ratio of the year under review and last year remained unchanged at 1: 3, the Quick Asset Ratio stands at 1: 2 due to the fact that the inventory value is at 34 per cent compared to the total current assets. Considering the company's Gross Profit Ratio, it was observed that the ratio of the year under review had decreased up to 1.4 per cent from 9.8 per cent in the preceding year. Similarly, the Net Profit Ratio had got a minus value of 1.3 per cent from 5 per cent in the preceding year.

3. Operational Review

3.1 Management Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	The Company had obtained an overdraft facility by securing a fixed deposit of Rs.8,490,000 during the year under review and at the end of the period under review, the overdraft balance was Rs.62,973,870 and a sum of Rs.9,358,767 had been paid as overdraft interest for the year 2020/2021. Further, a working capital loan of Rs.18,500,000 had been obtained and the interest of Rs.1,298,623 had been paid for it during the year under review. Accordingly, the management had failed to maintain a good financial position.	The bank overdraft had gradually increased due to a sum of Rs.50 million being given to Tea Shakthi Institute in the year 2015 and a sum of Rs.41 million for constructions and Rs.28 million for purchase of machinery were spent during the year 2015 in Manikdewela Tea Factory. Losses from the Menikdiwela and Hiniduma Hills factories, which were taken over without a feasibility study, had also contributed to the increase in bank overdrafts. Similarly, demand for processed tea had reduced on the adverse situation effected for international trade due to the lockdown of various countries and travel restrictions on the Covid 19 pandemic spread all over the world. As a result, tea prices at the auction are being decreased. This is a factor that directly affects the cash flow of the company. Furthermore, due to the restriction on the amount of fertilizer released for tea states, the	Management should take steps to maintain the financial position in a good condition.

		leaf yield of tea states had dropped drastically and plucked leaves turn yellow and ripe condition due to lack of fertilizer. The percentage of tea wastes and dust tea in the processed tea produced by this had increased and its NSA is very low. This is another factor that had negatively impacted the company's cash flow statement. During such a difficult period, the management had sought to reduce the bank overdraft from Rs.87 million at the end of the financial year 2019/2020 to Rs.62.9 million at the end of the financial year 20/21.	
(b)	The company had given a loan of Rs.50 million to the Tea Shakthi Fund in 2015 at an annual interest rate of 11 per cent and Buildings were constructed on the Menikdiwela land belonging to the Tea Shakthi Fund by spending a sum of Rs.59,532,264. According to the Cabinet Decision No. CP/19/0743/117/024 dated 19 March 2019, approval had been granted to legally take over the ownership of the Hiniduma and Menikdiwela factories for the loan, interest and development expenses incurred by the Company. However, the ownership had not been acquired till	As per the Cabinet decision, although the Menikdiwela Tea Factory had been handed over to our company, the necessary steps are being taken to take over the ownership of the land to the company and action will be taken to take over during this year.	As per the Cabinet decision, immediate action should be taken immediately to take over the ownership of the tea factories to the company.

the end of the year under review and receivables interest of Rs.5,500,000 per annum also had not been accounted.

3.2 Operational Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	The Hiniduma Hills and Menikdiwela Tea Factories, which were established by the Tea Shakthi Fund, had been handed over to the production process by the Cabinet Paper No. CP/19/0743/117/024 dated 19 March 2019 and it was stated that it should keep the two factories profitable without cost effect to the Treasury. After handing over these factories to the company in 2015, it was continued at the unprofitable condition until the year under review and the cumulative loss at the end of the year under review was Rs.112,475,388. The Derangala Tea Factory had also been suffering losses continuously since 2015.	Factors such as the difficulty in obtaining leaves in the area where the factories are located and the overall decline in the prices at the tea auction had been the main reason for the factories' loss.	The Company shall make all necessary arrangements to maintain a profitable manner in accordance with the Cabinet decision without incurring any cost to the General Treasury.
(b)	Although an action plan had been prepared for the company's 04 tea factories with a view to achieving several key objectives during the year under review, according to the information furnished to audit, when considering the progress of each sector as a whole, it was observed that the utilization was only Rs. 12 million out	The main factor affecting the inability to carry out the tasks mentioned in the action plan for the financial year 2020/21 is, the current Covid pandemic in the country. The travel restrictions, limitation of public gatherings and curfews etc, as per health advice, we were unable to carry out our	Adequate attention should be paid to the implementation of the tasks mentioned in the Annual Action Plan.

of the total estimated cost of Rs. 154 million and the company had also failed to make progress physically.

planned activities such as leaf promotion programmes, counseling programmes and training programmes etc. Further, the financial crisis also faced by the company during the financial year 2020/21 led to the non-implementation of the facts of the Action Plan. The collapse of the national and international processed tea market due to the Covid pandemic had caused financial problems for the tea industry as well as for our company and therefore, product promotion, new experiments and research activities other than daily operations had to be restricted or suspended temporarily. In addition, there are three private factories within the area (5 km) of the factory site and it was a reason to hamper in supplying leaves to our factory by the small tea state owners as these factories are buying inferior tea leaves at a price higher than the Board's approved price. Further, the leaf owner does not make any effort to improve the quality of the leaves due to the fact that the buyers of the leaves from those factories do not care about the quality of the leaves.

		It was not possible to implement programmes to increase human resource capacity due to the spread of the Covid pandemic in the financial year 2020/2021 and purchases are also restricted due to the adverse financial condition of the company. Therefore, it had not been possible to achieve significant performance as pointed out in the audit.	

3.3 Under -utilization of Funds

	Audit Issue	Management Comment	Recommendation
(a)	Although a sum of Rs.3.32 million for the purpose of increasing the human resource capacity of the Head Office of the Kalubowitiyana Tea Factory and providing the equipment including office equipment, a sum of Rs. 4.5 million for the implementation of market promotion campaigns and activities including finding foreign buyers with the aim of increasing the sales of the sale centre up to 16,000 kg per month had been allocated during the year under review, that money had not been utilized by the end of the year under review.	**Marketing Division** Due to the public sector will continue to operate with limited staff during this pandemic situation, those orders were limited and monthly orders continued to be missed. Similarly, sales fell due to buyers who stop purchasing bulk tea through the sales division under depopulated situation on the curfew and travel restrictions imposed. The Kalubowitiyana website is being updated currently to promote marketing. We have requested the Ministry of Plantation to give Cabinet approval to increase the net sales rate of factories by selling second-	Adequate attention should be paid to the implementation of the tasks mentioned in the Annual Action Plan.

		grade and non-main tea to government agencies. In addition, a request had been made to the Ministry of Plantations to sell the tea produced by our company directly to foreign countries through a bilateral agreement with the intervention of the Government.	

3.4 Procurement Management

	Audit Issue	Management Comment	Recommendation
(a)	A sum of Rs.1,566,002 had been retained due to the non-supply of 02 radiators to be supplied as per supply conditions for the water heat generator purchased in the year 2014 for a sum of Rs.23,414,275 from a private supplier by the Kalubowitiyana Tea Factory. Despite this, although the Board of Directors had decided to stop this payment on 21 December 2016 as the installation of the water heat generator had also been done defectively, that balance had not been settled until the end of the year under review.	Corrections will be made in the future.	Should be settled immediately.