State Timber Corporation

1. Financial Statements

1:1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, I am of opinion that the State Timber Corporation had maintained proper accounting records for the year ended 31 December 2010 and except for the effects on the financial statements of the matters referred to in paragraph 1:2 of this report, the financial statements have been prepared in accordance with Sri Lanka Accounting Standards and give a true and fair view of the state of affairs of the State Timber Corporation as at 31 December 2010 and the financial results of its operations and cash flows for the year then ended.

1:2 Comments on Financial Statements

1:2:1 Sri Lanka Accounting Standards (SLAS)

The following non-compliances were observed.

(a) The policy on making provision for the impairment of stocks had not been disclosed in the accounts in terms of Section 108 of SLAS No. 3.

(b) In terms of Section 36 (b) of SLAS No. 5 the value of stocks should be shown under a classification appropriate to the institution. Even though the trading stock of the Corporation amounting to Rs.475,958,178 could be classified as logs, sawn timber, sleepers, transmission poles and furniture as adopted for the computation of the sales cost, the trading stock had not been classified under such classification.

1:2:2 Accounting Deficiencies

The following deficiencies were observed.

(a) Overstatements

According to Note No. 09 to the financial statements, the provision for impairment of stocks had been shown as Rs.66,996,737 whereas according to the computation based on 15 per cent which is the accounting policy on impairment of stocks, the provision to be shown in the financial statements amounted to Rs.65,112,896. Therefore, the provision for the impairment of stocks had been overstated by a sum of Rs.1,883,841 in the accounts. This differences had been due to the adoption of the depreciation percentages ranging from 14.6 per cent to 18.6 per cent in the computation of impairment of stocks of 04 Regions / Units in respect of the year 2010.

(b) Understatements

The following deficiencies were observed.

(i) Even though the stumpage in the Cost of Timber Account had been shown as Rs.719,262,423, according to the undated letter No. WP/HC/6/6/2011(I) of the Conservator General of Forests addressed to the Director General (Treasury Operation) of the General Treasury, the stumpage for the year 2010 amounted to Rs.840,718,049. As such, it was observed that the stumpage had been understated by a sum of Rs.121,455,626 in the accounts of the Corporation.

(ii) According to the financial statements for the year under review the stumpage payable as at 31 December 2010 amounted to Rs.654,695,396. The sum receivable, according to the books of the Department of Forests amounted to Rs.820,591,958. As such the accrued expenditure had been understated by a sum of Rs.165,896,562. Similarly, the accrued expenses of for the year 2009 had also been understated by a sum of Rs.17,523,413.

(c) Classification Errors

The following classification errors were observed.

(i) Selling and distribution expenditure had not been shown separately in the Manufacturing, Trading and Profit and Loss Account of the Impregnation Section and the provision for doubtful debts amounting to Rs.15,621,049 had been shown under the administrative expenditure. In addition, all the expenditure on motor vehicle licences and insurance, repair and maintenance of motor vehicles and fuel and oil for motor vehicles totalling Rs.4,693,238 which should be shown under the selling and distribution expenditure had been shown as administrative expenditure.

(ii) The sum of Rs.3,338,412 representing repairs and maintenance expenditure shown in the Expenditure Account on Circuit Bungalows represented capital expenditure incurred on the repair of the Circuit Bungalow, Nuwara Eliya. That expenditure had been written off without being capitalized. The Chairman informed me that the land on which the building is situated is not owned by the Corporation and that it is a land belonging to the Department of Forests and if it is capitalized and depreciated at 2.5 per cent applicable to buildings it has to be depreciated over a period of 40 years and that most of the repairs were timber work and it was not capitalized on the assumption that it would not last that long.

(iii) A sum of Rs.5,528,850 had been shown as publicity expenditure in the Income Account of the Regional Managers' Offices and the Head Office and the entire amount had been shown under the establishment and administrative expenditure without being classified appropriately under the selling and distribution.

1:2:3 Unexplained Differences

The following differences were observed.

(a) Differences between Notes on Accounts and Branch Accounts

The following differences were observed between the Notes presented with the financial statements and the Income Statements prepared for each Branch, which form the source documents for the Notes, were observed.

(i) The following differences were observed between the Manufacturing Trading and Profit and Loss Accounts prepared for the Depots Section, Impregnation and Seasoning Section and the Furniture Section and Note 01 of the financial statements.

Category	According to Branch Accounts	According to Note to Financial Statements	Differences
	Rs.	Rs.	Rs.
Logs	1,609,611,726	1,618,850,718	9,238,992
Logs (Private Lands)	4,964,618	15,270,267	10,308,649
Sawn Timber	213,158,844	206,807,516	6,351,328
Sleepers	651,335,912	651,556,246	230,334
Transmission Poles	171,589,777	171,633,813	44,036
Others	149,306,612	136,211,470	13,095,142

(ii) According to Note 05 of the financial statements, sundry income amounted to Rs.23,073,605 whereas according to sundry accounts, the sundry income amounted to Rs.22,773,606. As such a difference of Rs.299,999 was observed.

(b) According to the Reconciliation Statements prepared for the Housing Loan Account maintained by the Corporation with the State Mortgage and Investment Bank, the balance as at 31 December 2007 amounted to Rs.35,566,113 and the balance according to the Bank Statements amounted to Rs.34,307,710. As such a difference of Rs.1,258,403 was observed. Action had not been taken even up to 30 June 2011 to adjust the difference.

1:2:4 Accounts Receivable and Payable

The following observations are made in this connection.

(a) According to the decision No. 01.11.11/2346 dated 13 January 2011 of the Board of Directors, it had been decided to write off in the year 2010 the trading debtor balances of Rs.1,780,933 lapsed for over 05 years, receivable from 12 Government Departments without obtaining the approval of the Treasury. Even though those institutions were functioning, action had not been taken to recover the debts. It was observed that the said amount included a sum of Rs.256,429 less than 05 years old receivable from 09 State institutions.

(b) It was observed in audit that no action had been taken since 21 November 1985 for the recovery of a sum of Rs.11,873,865 receivable from a certain company from the year 1983. Action had also not been taken to obtain the Treasury approval for the write off of this amount.

(c) Deposits lapsed for more than 02 years from the date of deposits should be credited to the income of the Corporation after making enquiries. Nevertheless, action in terms of Financial Regulation 571(2) had not been taken on retention money amounting to Rs.9,325,685, non-refundable tender deposits amounting to Rs.2,049,701 and security deposits amounting to Rs.6,916,765 shown under the Accounts Payable and Creditors respectively over a number of years as at 31 December 2010.

1:2:5 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following non-compliances were observed.

	Reference to Laws, Rules, Regulations etc.	Non – compliance
(a)	Public Enterprises Circular No. PED/12 of 02 June 2003	
	(i) Section 4.2.2	The Board had not periodically reviewed its Corporate Plan, Budget and performance to ensure that the actual performance is in line with the Plan and take timely remedial action,

if wide discrepancies exist and wherever necessary to revise the Plan/ Budget.

(ii) Section 4.2.5	Even though the Board should review the following statements on a monthly basis for the effective management of its working capital it had not been so done. (a) Age analysis of debtors and creditors (b) Age analysis of stocks (c) Statements identifying old, obsolete and slow moving stocks and other items.
(iii) Section 7.4.1	Even though the Audit and Management Committees should meet at least once in 03 months, no meetings had been held from 13 October 2009 to 04 November 2010.

(b) Procurement Guidelines

(i) Section 2.8.4	Even though the Chairman should appoint Technical Evaluation Committees, it had not been so done.
(ii) Section 4.2.1	The Corporation had not prepared a Master Procurement Plan and a Procurement Plan for the year 2010.

(c) Treasury Circular No. 01/2004 dated 24 February 2004

(i) Section 6.1.1	Even though the draft Annual Report should be presented to the Auditor General within 60 days from the close of the financial year that report had not been presented even up to 30 June 2011.
(ii) Section 6.1.4	The Annual Report of the Corporation for the year 2009 had not been tabled in Parliament even up to 30 June 2011.

2. Financial and Operating Review

2:1 Financial Review

2:1:1 Financial Results

The operating result of the Corporation for the year under review before the computation of the taxes paid to the Treasury and the income tax had been a net profit of Rs. 877,623,257 as compared with the net profit of Rs.810,611,551 for the preceding year before the computation of taxes paid to the Treasury and income tax. Thus an increase of Rs.67,011,706 in the net profit was indicated. A profit of Rs.615,230,379 had been earned from the primary operations of the Corporation and that as compared with the profit of Rs.565,737,349 earned from the primary operations of the preceding year indicated an increase of Rs.49,493,030. This had been mainly due to the increase of Rs.164,108,886 in the sales and the decrease of selling and distribution expenses by Rs.47,371,519 for the year.

2:1:2 Analytical Financial Review

The gross profit percentage of the Corporation for the year had been 41 per cent and the net profit percentage before the taxes paid to the Treasury and the income tax had been 27 per cent. The corresponding gross profit percentage for the preceding year had been 43 per cent and the net profit percentage before the taxes paid to the Treasury and the income tax had been 26 per cent. Accordingly a decrease of 2 per cent in the gross profit percentage and an increase of 1 per cent in the net profit percentage were observed.

2:2 Operating Review

2:2:1 Performance

The following observations are made.

(a) Import of Sawn Timber

According to the Corporate Plan (2008-2012), the Corporation had planned for the import of 5,000 cubic metres of sawn timber to meet the national sawn timber requirements of the year under review and to earn an income of Rs.593.75 million therefrom. Nevertheless timber had not been imported in the year 2010.

(b) Furniture Division

(i) According to the financial statements, the actual furniture sales of the Corporation in the year under review amounted to Rs.66.39 million and that amounted to a shortfall of Rs. 147.95 million from the budgeted sales amounting to Rs.214.34 million. The loss of the Furniture Division for the year under review amounted to Rs.32.56 million.

(ii) According to the Corporate Plan of the Corporation, plans had been made for increasing the sale income of the Furniture Division by Rs.180 million in the year 2010, Rs.190 million in the year 2011 and Rs.200 million in the year 2012. Nevertheless, the actual sale of furniture in the year under review amounted to Rs.66 million. Even though an improvement of the sale of furniture amounting to 23.9 per cent as compared with the preceding year was indicated, it had not been possible to achieve the targets according to the Corporate Plan.

(iii) A productive course of action for the promotion of the sale of furniture by the Corporation had not been launched in the year 2010. The Chairman informed me that the "Prasada Abimani" package for the sale of furniture at easy payment terms up to Rs.100,000 to the Public servants was introduced for the promotion of sale of furniture in the year 2010 and that there is a large demand for that at present and that an extensive publicity programme through the issue of vouchers, distribution of handbills and newspaper advertisements and television advertisements were launched and that action was also taken for the promotion of office furniture through the distribution of handbills".

(iv) The main reasons for the decrease in the sale of furniture by the Corporation had been the lack of competitive prices and failure to minimize the cost of furniture.

(c) Agricultural Productions

The Corporation had not taken any steps on agricultural productions in the year under review while no plans had also been made for achieving the objectives.

(d) Processing of Forest related Products and Import of Cane

The Corporation had not taken any action in the year under review for the processing of forest based productions and import of cane.

(e) Manufacture and Marketing of by-products from Timber and Export of timber related finished or semi-finished Products

The Corporation had not taken any steps whatsoever during the year under review for the implementation of these activities included under the objectives of the Corporation.

(f) Timber and Timber related Products

The actual production of the Corporation for the year under review as compared with the estimated production is given below.

Particulars	Estimated Production	Actual Production	Variance Favourable/ (Adverse)
Timber Logs (Cubic Metres)	139,241	137,317	(1,924)
Sawn Timber (Cubic Metres)	7,470	5,519	(1,951)
Transmission Poles (Units)	60,700	19,472	(41,228)
Sleepers(Units)	150,000	133,822	(16,178)
Round Poles (Units)	53,000	105,253	52,253
Fence Posts (Units)	50,800	79,858	29,058
Firewood (Cubic Metres)	39,400	118,544	79,144
Wall Panels (Linear Metres)	60,000	4,974	(55,026)
Elephant Fence Posts (Units)	24,500	20,812	(3,685)
Furniture (Rs. Millions)	214.28	90.57	(123.71)

A reconciliation of the actual production with the estimated production revealed adverse variances relating to the sawn timber by 26.1 per cent, transmission poles by 67.9 per cent, Wall Panel by 91.7 per cent and furniture by 57.7 per cent. As such it was observed that the Corporation had failed to achieve the production targets.

(g) Impregnation and Seasoning Section

The production of sleepers and transmission poles in the year 2010 as compared with the preceding year had decreased by Rs.243,516,073 and Rs.148,332,621 respectively. Nevertheless, the expenditure incurred on the furnace oil for the Impregnation and Seasoning Section in the year 2010 exceeded the expenditure for the year 2009 by Rs.3,149,821. The reasons therefor were not revealed.

2:2:2 Deficiencies in Contract Administration

Construction of Steel Stacking Sheds for the State Timber Corporation – Rs.29,784,885

The following observations were made in this connection.

(a) The Corporation had called for quotations in writing on 14 March 2008 for the construction of Stacking Sheds in accordance with a quotation of Rs. 1,461,850 based on a plan, bill of quantity and wages prepared by a contractor instead preparing bills of quantities based on the requirements of the Corporation and without stating the proposed sites and the number of Stacking Sheds.

(b) Even though the approval had been granted on 24 April 2008 for awarding the contract to the bidder who quoted the lowest bid of Rs.1,416,190, quotations had been obtained from 02 institutions on 26 May 2008 and the Chairman had granted a approval on 28 July 2008 to get the civil engineering works done through the first contractor at Rs.684,850 per unit and to get the steel fabricating works done through another institution at Rs.623,000 per unit. As such the cost per Stacking shed amounted to Rs.1,307,850. The failure of the Corporation to award the contract to the contractor who quoted the lowest quotation of Rs.1,259,442 in the second occasion for steel fabricating works and civil engineering works had resulted in a loss of Rs.48,408 per shed. The total loss incurred on the 12 sheds constructed amounted to Rs.580,896.

(c) A Technical Evaluation Committee had not been appointed in terms of Section 2.8.4 of the Procurement Guidelines and the contractors had been selected without an evaluation by a Technical Evaluation Committee.

2:2:3 Management Inefficiencies

The following observations are made in this connection.

(a) Cash and Bank Balances

The Corporation had opened a non-resident foreign currency account in the Bank of Ceylon in the year 2006 for the export of timber. The balance of that account as at 31 December 2009 amounted to US$150,036.62 and the balance as at 31 December 2010 amounted US$151,165.69 (Rs.16,718,925). The export of timber had been stopped from the year 2008 and the reasons for retaining such a large amount of money in the Bank Account had not been revealed. The cash with high liquidity had not been effectively and efficiently managed. The Chairman informed me that the non-resident foreign currency account is further maintained with the expectation of capital gains from the appreciation of the value of the Dollar as well as the expectation of carrying out foreign transactions in the future.

(b) Rejected Sleepers

The sales value of rejected sleepers of the Impregnation and Curing Division for the year 2010 amounted to Rs.3,970,334 and as compared with Rs.792,028 for the year 2009 indicating and increase of 401 per cent. As such a stock of high value sleepers had been rejected.

(c) Accounting Information System

The Acpac Accounting Information System used by the Corporation for the preparation of accounts and financial statements is in use from the year 1992 up to date. The existence of deficiencies from the date of introduction of the system up to date was observed. It was also observed that there are delays in the preparation of the final accounts due to the unavailability of a proper accounting system.

(d) Purchases and Procurement of Services – Head Office

(i) Printing of Cash Sales Invoices – Rs.2,480,240

The open competitive bidding procedure in terms of Section 2.14.1 of the Procurement Manual had not been followed in carrying out the above printing work and the contract had been awarded for Rs.2,480,240 to the only company that furnished quotations in response to the limited quotations called for. According to the bid conditions, the supplier should have handed over the printed books within 30 days. Nevertheless, the handing over of 1,502 books or ¾ of the total stock of 2,000 books had been delayed up to 121 days. As the agreement entered into between the Corporation and the supplier on 04 June 2010 did not indicate the specific date for handing over of the books, liquidated damages could not be recovered.

(ii) Printing Books of Advice Notes for Issues from Forests – Rs.1,499,680

Limited quotations had been called for in connection with the above printing without following the bid procedure in terms of Section 2.14.1 of the Procurement Manual. Even though it had been stated that the supplier would supply the printed books within 07 days from the date of proof reading by the Corporation, the handing over of the printed books to the Corporation had been inordinately delayed by 41 days to 95 days. Out of the total stock of 1,000 books, handover of 500 books had been delayed for 95 days. As the Corporation had not entered into a formal agreement with the supplier, liquidated damages could not be recovered.

(iii) Purchase of Two Hino make 2 WD 10 Ton Truck Chassis with 04 Ton Telescopic Boom Cranes – Rs.18,355,600

The bid for the purchase of two 10 ton Hino make truck chassis for Japan Yen 11,220,000 had been awarded by the Corporation to a certain company on 11 February 2010. According to condition 9 of the Bid Acceptance Letter, the supplier should have furnished a Performance Bond for a sum of Rs.1,458,824 equivalent to Japan Yen 1,122,000 representing 10 per cent of the Free on Board Price. Nevertheless, the Performance Bond furnished by the said company had been only for a sum of Rs.730,000, that is, 5 per cent. As that Performance Bond could not be accepted the Corporation should have obtained a fresh Performance Bond. It had not been so done. Even though the validity period of the Performance Bond expired on 21 August 2010, the Corporation had not taken action to get the validity period extended before its expiry.

2:2:4 Irregular Transactions

(a) Staff Promotions

The following observations are made in this connection.

(i) The recommendations presented by the National Salaries and Cadre Commission on the restructure of the cadre of the State Timber Corporation had been approved by the letter No. DMS/E2/58/4/371/2 date 22 September 2009 of the Department of Management Services addressed to the Secretary to the Ministry of Environment and Natural Resources. According to paragraph 08 of that letter, the schemes of Recruitment and Promotions should be prepared on the basis of the approved organization structure and the salary scales in conformity with the provisions of the

Management Services Circular No. 30 and obtain the approval thereof from the Department of Management Services before the implementation of the restructure recommendations. Nevertheless, the Corporation had, without obtaining the approval for the Schemes of Recruitment and Promotions, promoted 07 Acting Deputy Regional Managers/ Assistant Regional Managers, an Acting Regional Managers and 03 Regional Managers as Deputy Regional Managers, 02 Acting Deputy General Managers, 02 Managers and 02 Assistant General Managers as Deputy General Managers and 04 Acting Regional Managers/ Regional Deputy Managers as Regional Managers in accordance with a decision of the Board of Directors.

(ii) Even though paragraph 10 of the said letter specifically emphasized that the implementation of the restructure proposals is not an approval granted for recruitment to such posts, recruitment had been made to the posts in the manner stated above.

(iii) Five officers who were promoted as referred to at paragraph (a) above had been paid the salaries of the new posts with effect from March 2010.

(b) Removal of Timber from Area under the Borawewa Development

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As the contractor entrusted with the work site had been found guilty of unauthorized felling of timber, the award had been terminated and the Procurement Committee had approved the splitting of the work site to two sections and awarding the contracts to 02 contractors on 10, August 2010. Even though 02 months had elapsed after the expiry of the agreed period by 09 December 2010, the contractor had further delayed the removal of timber. The reason for the delay had been due to awarding 02 Work Sites to a contractor who had breached the conditions of agreements even during prior years.

It should be pointed out that this type of incidents happen due to the failure of the Corporation to maintain proper records of the previous agreements of contractors and the non-maintenance of records of contractors who breach contracts.

2:2:5 Uneconomic Transactions

The following observations are made.

(a) Even though the Corporation had incurred preliminary expenditure amounting to Rs.468,000 in the year 2001 to establish a joint venture company and invested a sum of Rs.30,000,000 in that company, Corporation had not received any dividend even up to 30 June 2011.

(c) The Corporation had granted an interest free loan of Rs.2,000,000 in the year 1988 to the “Astaphala Fund” of Katharamagama. A sum of Rs.32,000 out of that had been received in the year and a loan balance of Rs.1,115,000 remained recoverable as at 30 June 2011.

2:2:6 Resources of the Corporation supplied to Other State Institutions

Contrary to the provisions of Section 8.3.9 of the Public Enterprises Circular No. PED/121 of 02 June 2003, two motor vehicles of the Corporation had been released to external persons.

2:2:7 Identified Losses

A loss of Rs.1,147,565 had been incurred in the year under review by the Corporation by an accident caused to a motor vehicle.

2:2:8 Action Plan

Even though an Action Plan had been prepared for the year 2010 the following deficiencies therein were observed.

(a) The Action Plan had been prepared with the sole objective of the production and sale of timber while not action had been taken to prepare the plan by paying attention to all the Sections of the Corporation.

(b) Even though the officers entrusted with the responsibility for the achievement of the objectives and targets of the Corporation during the relevant year should be specifically stated therein, such identification had not been made in the Action Plan for the year 2010. In this connection, the attention is drawn to Section 5.1.2 of the Public Enterprises Circular No. PED/12 of 02 June 2002.

2:2:9 Budgetary Control

The budget for the year 2010 had not been based on the Corporate Plan and the Action Plan of the Corporation in terms of Sections 5.2 and 8.1.3 of the Public Enterprises Circular No. PED/12 of 02 June 2003.

The estimated differences amounting to Rs.625,124,289 between the budget and the Action Plan the Corporation further indicated that it had not been prepared in concurrence with those documents.

A reconciliation of the estimated income and expenditure with the actual income and expenditure for the year under review revealed variances between 0.46 per cent to 100 per cent and as such the budget had not been made use of as an effective instrument of control. In addition, special attention should be paid to estimating of sundry income.

3. Systems and Controls

Deficiencies and Systems and controls observed during the course of audit were brought to the notice of the Chairman of the Corporation. Special attention is needed in respect of the following areas of control.

(a) Accounting
(b) Debtors
(c) Budget
(d) Stores
(e) Fixed Assets
(f) Purchase of Goods/ Services
(g) Maintenance of Contract Files