# Ceylon Petroleum Corporation – 2011
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## 1. Financial Statements

### 1.1 Qualified Opinion

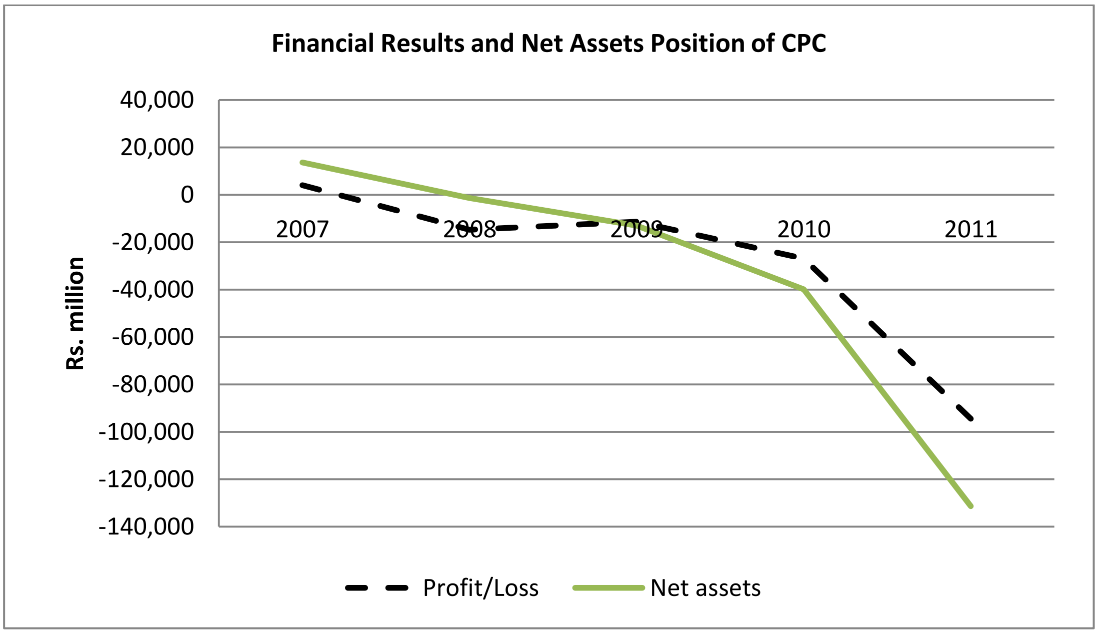
In my opinion, except for the effects on the financial statements of the matters referred to in paragraph 1.2 of this report, the financial statements give a true and fair view of the financial position of the Ceylon Petroleum Corporation as at 31 December 2011, and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In my opinion, except for the effects on the consolidated financial statements of the matters referred to in paragraph 1.2 of this report, the consolidated financial statements give a true and fair view of the financial position of the Ceylon Petroleum Corporation and its subsidiary as at 31 December 2011 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### 1.2 Comments on financial statements

### 1.2.1 Appropriateness of Going Concern Assumption

The Corporation had sustained a loss of Rs. 94,508 million (without tax adjustment) for the year under review and had a negative net assets position of Rs. 131,324 million as at the end of the year 2011 due to sustain heavy losses for the last four years. Thus, the ability of the Corporation to continue as a going concern without the financial assistance from the Government of Sri Lanka and other financial institutions is doubtful. Financial results and the net assets position of the Corporation for the year under review and last four years are depicted in the chart given below.



### 1.2.2 Delay in presentation of financial statements

According to the Circular No. PED/12 of 02 June 2003 of the Department of Public Enterprises, the annual accounts should be rendered to the Auditor General within 60 days after the close of the financial year. However, consolidated annual financial statements had been submitted to the Auditor General only on 15 January 2013 for the year under review.

### 1.2.3 Non-compliance with Sri Lanka Accounting Standards (SLAS)

The following observations are made.

(a) One third of the total shares of the Ceylon Petroleum Storage Terminal Ltd (CPSTL), held by the General Treasury, had been transferred on 21 October 2009 to the Corporation with effect from 01 January 2009. As a result, the ownership to the Corporation of the total shares of the CPSTL had increased up to 2/3. Accordingly, the Corporation should have prepared and presented consolidated financial statements for the year 2010 and onwards in which it should consolidate its investments in subsidiaries in accordance with the Sri Lanka Accounting Standard No. 26. However, the Corporation had prepared consolidated financial statements for the year 2011 based on unaudited financial statements of the CPSTL.

(b) The Corporation had not revalued its property, plant and equipment to ensure that the carrying amounts did not differ materially from the fair value, which would be determined at the balance sheet date, as stipulated in SLAS 18 – Property, Plant and Equipment. Further, fully depreciated assets valued at Rs. 3,130 million, which continued to be used by the Corporation had not been revalued.

(c) The Corporation had not adopted appropriate procedures to identify impairment indicators for its property, plant and equipment amounting to Rs. 10,891 million as required by SLAS 41- Impairment of Assets.

(d) It was observed that bad debt provision amounting to Rs. 43.4 million had not been shown in the face of the balance sheet as stipulated in SLAS 3, instead of setting off against trade receivable balances. In addition, the bad debt provision of the carrying amount at the beginning and the end of the year had not been disclosed as required by SLAS 36 – Provisions, Contingent Liabilities and Contingent Assets.

### 1.2.4 Accounts Receivable and Payable

The details of the long outstanding receivable balances of the Corporation as at the Balance sheet date were as follows.

| **Item** | **Total dues as at 31 December 2011** |
|---|---|
| | **Rs.** |
| Dealers | 790,349,862 |
| Aviation | 14,710,932,214 |
| Power Plants | 8,974,762,742 |
| Government Consumers | 90,024,815,525 |
| Private Consumers | 263,130,856 |
| Agro Chemical | 22,917,925 |
| Others | 283,926,228 |
| **Total** | **115,070,835,353** |

The following observations are made in this regard.

(a) Details of age analysis relating to the above mentioned dues were not made available to audit even though called for several times. Accordingly, it was observed that such information had not been maintained properly by the Corporation.

(b) It was observed that the Corporation had provided credit facilities aggregating Rs. 25.1 million to four private dealers, a private power plant customer and a private aviation customer, and Rs. 24 million to three Government customers exceeding their bank guarantees.

(c) The amount receivable from the Ceylon Electricity Board (CEB) as at 31 December 2011 was amounted to Rs. 67,259 million and out of that Rs. 50,500 million had been recovered from the Treasury Bond given to Corporation on 04 January 2012.

(d) The Corporation normally calls confirmation from debtors for all outstanding balances available as at the end of each year. Out of the total outstanding balance of Rs. 115,070.8 million (before bad debt provision) as at 31 December 2011, a sum of Rs. 69,132 million due from 114 debtors were not conformed to the amount confirmed by respective debtors. Accordingly, it was observed a difference of Rs. 87,700 million between the ledger balance and the balances confirmed by respective debtors. Details are as follows.

| No. of debtors | Ledger balance | Balance confirmed by debtors | Difference between the ledger balance and the confirmed balance |
|---|---|---|---|
| | Rs. million | Rs. million | Rs. million |
| 49 | 47,220 | Nil | 47,220 |
| 38 | 1,753 | 1,402 | 351 |
| 27 | 20,159 | 60,288 | 40,129 |
| **Total** | | | **87,700** |

(i) Out of Rs. 47,220 million of ledger balance relating to 49 debtors, by whom the balances had been confirmed as nil, there was a difference of Rs. 4.5 million relating to 06 dealers due to an implementation error of the Enterprise Resource Planning/ System Applications and Products for Data Processing (ERP/SAP) system.

(ii) Further, out of the above total dues, there was a dispute regarding a balance of Rs. 8 million due from two other institutions.

(iii) Out of 38 debtors who had confirmed their balances below the amount in the ledger balances of the Corporation, there was a dispute relating to the balances of two debtors aggregating Rs. 2.7 million.

(iv) 27 customers had confirmed their balances over the ledger balances by Rs. 40,129 million.

(e) It was observed that 1.5 per cent of debtor balances amounting to Rs. 1,725 million as at 31 December 2011 were remained outstanding for a period ranging from one year to eighteen years, included in the total debtor balances of Rs. 115,070.4 million (before bad debt provision) shown in the financial statements as at 31 December 2011.

(f) According to the operating system (SAP) of the Corporation, hard cash customers were allowed to make payments in cash at the point of sale and no credit facilities were provided to them. However, there was an outstanding balance of Rs. 21.6 million of such customers as at 31 December 2011.

### 1.2.5 Lack of Evidence for Audit

The following items in the accounts could not be satisfactorily vouched in audit due to the non-availability of required evidence as indicated below.

(a) Twenty five acres of land valued at Rs. 259 million at Muthurajawela had been shown as an asset in the ledger. However, there were no Title Deeds or Vesting Orders made available to establish the ownership of the land.

(b) Adequate evidence had not been made available to examine the recoverability and existence of the excise duty amounting to Rs. 714 million receivable from the General Treasury and included under Trade and Other Receivables.

(c) Poor maintenance of records relating to the motor vehicles

(i) According to the information made available, the Corporation had not maintained proper records relating to the fleet of vehicles owned by the Corporation. Also, following information had not been made available to audit even after requesting several times. Therefore, expenditure incurred by the Corporation could not be satisfactorily vouched in audit.

- Losses on accidents occurred during the year
- Details of group transportation provided by the Corporation
- Details of officers who were entitled for and provided group transport facilities by the Corporation.
- Details of vehicles acquired on lease basis

### 1.2.6 Non-compliance with Laws, Rules, Regulations and Management Decisions

Following instances of non-compliance with Laws, Rules, Regulations and Management Decisions were observed in audit.

| Reference to Laws, Rules, Regulations and Management Decisions. | Non- compliance |
|---|---|
| (a) Public Enterprises Circular No. PED/12 of 2 June 2003 on Public Enterprises Guidelines for Good Governance. | |
| (i) Section 3.2 | The Board of Directors of the Corporation did not include at least one member in the field of Petroleum industry. |
| (ii) Section 4.2.2 | Board Meetings of the Corporation had not been held during January, March, May, July, August and November of the year 2011. |

| | | |
|---|---|---|
| (b) | Circular No. 124 dated 24 October 1997 of the Ministry of Finance and Planning. | Even though, covering up duties of a vacant post should be limited to a period of 03 months, five employees had been covering up duties of vacant posts for periods ranging from 4 to 14 months up to the end of the year under review. |

### 1.2.7 Transactions not Supported by Adequate Authority

In terms of Section 8.3.3 of the Public Enterprise Circular No. PED/12 of 2 June 2003, bonus could be paid to employees out of the profit earned by the Corporation. Nevertheless, the Board of Directors had approved and paid bonus amounting to Rs. 147 million, Rs. 148 million, Rs. 179 million and Rs. 175.6 million in the years of 2008, 2009, 2010, and 2011 respectively despite the losses occurred to the Corporation in these respective years.

### 1.2.8 Hedging Transactions

According to the minutes of the Board of Directors of the Corporation, arbitration proceedings were being conducted at the London Court of International Arbitration. The Corporation was cited as a party in the arbitration proceeding pertaining to hedging contracts entered into with several commercial banks. Pending the outcome of these proceedings at the London Court of International Arbitration, the Corporation had not recognized any resultant liability. *"As per the Chairman of the Corporation, US$ 60 million had been paid to the Standard Chartered Bank (SCB) with the approval of the Board of Directors and the Cabinet of Ministers under the Deed of settlement entered between parties and the payment had been remitted to SCB on 3 June 2013."*

## 2. Financial and Operating Review

### 2.1 Financial Review

### 2.1.1 Financial Results

According to the financial statements presented, the operation of the Corporation for the year under review had resulted in a pre-tax net loss of Rs. 94,508 million as compared with the corresponding pre-tax net loss of Rs. 26,923 million for the preceding year, thus indicating a further deterioration of Rs. 67,585 million in the financial results. The main reasons for the deterioration were, provision of fuel to Srilankan Airlines Ltd and Mihin Lanka (Pvt.) Ltd at concessionary rates, inefficiencies in procurement process of petroleum products of the Corporation, provision of furnace oil at subsidized rate to CEB, lack of proper Stock level maintenance program and storage facilities, demurrages etc.

### 2.1.2 Analytical Review of the Financial Results and Financial Position

The following observations are made.

(a) The following analysis depicted the poor performance in the management of working capital for the year under review.

(i) The current ratio as at the end of the year under review indicated 0.58 times as compared with 0.82 times of the preceding year and had shown a slight downward move while the acid test ratio had decreased from 0.57 times to 0.45 times at the end of the year under review. This position clearly shows that the liquidity position of the Corporation was in an adverse position.

(ii) The debtor turnover ratio for the year indicated 3.7 times as compared with 3.4 times for the preceding year and the debt collection period had decreased to 99 days as compared with 108 days for the preceding year, which shows that the performance of the debt collection had slightly improved.

(iii) The stock residence period had decreased to 34 days as against 46 days for the preceding year thus showing an improvement in the stock turnover.

(iv) The creditor turnover ratio for the year indicated 3.1 times as compared with 2.3 times for the preceding year and the credit payment period had decreased to 117 days as compared with 158 days for the preceding year.

(v) The cash operating cycle had increased to 15 days as against minus 5 days of the preceding year thus showing an increase of 20 days, and it might result in the increase of the working capital difficulties.

(vi) Debt to equity capital portion of the year under review had increased up to 151:(131) as compared with 47:(37) for the year 2010. Accordingly, the negative amount of the total equity had increased by Rs. 94 billion when compared with the previous year.

(vii) The gross profit margin for the year under review had decreased to negative 20.1 percent as compared with negative 3.6 percent for the preceding year. Accordingly, the gross loss had increased by Rs. 62.3 billion (71.6 – 9.3) during the year under review when compared with the previous year.

(viii) The return on capital-employed ratio showed a negative position during the year under review as well as previous year.

(ix) The return on total assets ratio indicated a negative of 51 per cent of the year under review as compared with the negative of 18 per cent in the preceding year.

(x) Interest coverage ratio had increased to negative of 9.5 times during the year under review as compared with negative of 2.9 times for the preceding year.

## 2.2 Operating Review

### 2.2.1 Performance

Following observations are made.

(a) The agreement entered into between a private gas company and Ceylon Petroleum Corporation in respect of liquid petroleum gas sales had expired on 20 October 2006. However, the Corporation had supplied liquid petroleum gas to that company continuously without entering into a fresh agreement or renewing the agreement. Instead, the supply of gas had been continued on a letter given by the Minister of Petroleum Industries. In addition, the Corporation had supplied liquid petroleum gas to another private company without entering into an agreement.

(b) Some of the products of the Corporation had been sold at prices less than the production cost. It appears that those loss making products had attributed for the huge net loss significantly as well as for the negative net assets position of the Corporation as at the end of the year under review. *As per the Chairman of the Corporation, Majority of the products were sold at subsidized prices due to Government policy.*

The details are given below.

| Product | Sales Value Rs. Mn. | Cost of Sales Rs. Mn. | Gross Loss Rs. Mn. | Net Profit at the year-end 2011 |
|---|---|---|---|---|
| Fuel Oil 3500 (power) | 165,800 | 200,392 | 34,592 | Net Loss (Before Tax) for the year ended 31 December 2011 amounted to Rs. 94,509 million. Power generation fuel oil and Lanka Auto Diesel had attributed for a gross loss of Rs. 27,783 Mn. and Rs. 34,592 Mn. respectively. |
| Fuel Oil 1500 (power) | 10,823 | 19,197 | 8,374 | |
| Fuel Oil (others) | 25,458 | 44,867 | 19,409 | |
| Agro Chemicals | 13,710 | 19,888 | 6,179 | |
| LPG | 2,319 | 2,463 | 144 | |
| Kerosene | 12,804 | 19,541 | 6,736 | |
| Fuel Oil (Bunkering) | 3,647 | 4,065 | 417 | |
| Naphtha | 4,331 | 4,829 | 498 | |

### 2.2.2 Utilization of Corporation's Resources by Other Government Institutions

Following observations are made.

(a) As per Section 9.4 of the Public Enterprises Circular No. PED/12 of 02 June 2003, an employee of an enterprise should not be released to the Ministry or any other institution, without the approval of the Cabinet and the enterprise should not pay any emolument to the released employee during such period. However, in contrary to such instructions, 28 employees had been released to six Government Institutions without the approval of the Cabinet of Ministers.

(b) As per Section 8.9.3 of the Public Enterprises Circular No. PED/12 of 02 June 2003, public enterprises are not permitted to incur expenditure or deploy its resources under any circumstances, on behalf of the line Ministry or any other Government institutions. It was revealed that, a number of motor vehicles had been released to the line Ministry and other institutions during the year under review in contrary to the above circular provision and provisions in Letter No. CSA/P1/40 of 04 January 2006 issued by His Excellency the President and the Public Enterprise Circular No. 116 of 24 January 1997.

### 2.2.3 Identified Losses

The following observations are made.

(a) The Corporation had made bunkering business through a private company in April 2008 with the intention of carrying out that business in the future. According to the Corporation, at the commencement of the business, the environment was not favorable to the Corporation since it had to adopt different strategies to compete with other competitors in the market. Therefore, during the period of April 2008 to December 2008 and January 2009 to May 2009, the Corporation had sold fuel at a reduced price to a private company and as a result, the Corporation had sustained losses amounting to Rs. 85.2 million and Rs. 125 million (approximately) respectively from the bunkering business. However, the Corporation had not engaged in bunkering business since April 2009 and value of stocks as at 31 December 2011 amounting to Rs. 2.17 million (approximately) had been held at the Jaya Container Terminal Oil Bank.

(b) According to the pricing policy of the Corporation, Aviation Turbine Fuel had been sold at spot customer price as well as contract customer price, which was lower than the spot customer price. Even though Srilankan Airlines Ltd. and Mihin Lanka (Pvt.) Ltd. were the contract customers, fuel had been issued to them at concessionary rates which were lower than the contract customer price. Concessionary prices offered for the above two companies had been calculated on the basis of deducting special rates (amounts) from the fixed cost (freight, insurance, storage and marketing). Details are as follows.

| Name of the Company | Amounts deducted from the fixed cost of Fuel per barrel US$ |
|---|---|
| Srilankan Airlines Ltd | 0.13 |
| Mihin Lanka (Pvt.) Ltd | 0.03 |

Accordingly, when compared with the contract customer price, the Corporation had occurred losses of Rs. 470.41 and Rs. 548.49 during the years of 2010 and 2011 respectively, on the sale of Aviation Turbine Fuel to Srilankan Airlines Ltd. and Mihin Lanka (Pvt.) Ltd. at concessionary rates. Furthermore, it was observed that there were long outstanding balances due from the said companies as at the end of the year under review and the previous year. Details are as follows.

| Name of the Company | Outstanding balance as at | |
|---|---|---|
| | 31 December 2011 Rs. | 31 December 2010 Rs. |
| Srilankan Airlines Ltd | 12,351,426,871 | 541,542,674 |
| Mihin Lanka (Pvt.) Ltd | 1,227,020,419 | 361,235,191 |

Accordingly, it was observed that despite losses sustained and negative equity position since the year 2008, the Corporation had provided Aviation Turbine Fuel to the above two private companies at concessionary rates, even though such companies were within a default risk position and making continuous losses.

### 2.2.4 Management Inefficiencies

The following observations are made.

(a) No proper evaluation of the risk involved in linking the Corporation data base to an Enterprise Resource Planning (ERP) system developed by the Ceylon Petroleum Storage Terminal Ltd with the assistance of the Indian Oil Company (the parent company) of the major industry competitor of the Corporation had been made by the Corporation. Since the Corporation has to commit significant amount of its resources (both capital and human) for this purpose, a proper and in-depth analysis of the impacts that would arise through this system integration should have been made with the assistance of experts in the field of Enterprise Resource Planning System. Further, it was observed that there was no agreement or a Memorandum of Understanding amongst the Corporation, Ceylon Petroleum Storage Terminal Limited and Lanka Indian Oil Company with regard to their respective responsibilities under this project before the implementation. It was also important to have an agreement/memorandum as a precautionary measure, taking into account the significant outlay of capital and human resources utilized by the Corporation to upgrade its equipment etc. to be compatible with the Enterprise Resource Planning System introduced by the Ceylon Petroleum Storage Terminal Limited.

(b) The Corporation had made major investments amounting to Rs. 5,037 million (including the investment of Rs. 5,000 million in the CPSTL) in various portfolios. However, no considerable income (only Rs. 3,000) had been generated on these investments as at 31 December 2011. Accordingly, it was observed that proper attention had not been paid on the return on investment (ROI) before investing funds of the Corporation.

(c) According to the agreement entered into with the Lanka Indian Oil Company, the Government of Sri Lanka and the Corporation in the year 2003 relating to the taking over of possession and related matters of the China Bay installation, the Corporation had agreed to lease the storage facilities and the land to the said Company for a period of thirty five years and that lease agreement should be executed within 06 months from the date of the agreement. However, the Corporation had not yet entered into any lease agreement, and no related lease rentals had been received from the company for the usage of this storage facility, although the Company had already been using the facility since February 2003.

(d) A sum of US$ 795,393.7 had been spent by the Corporation as demurrage charges on finished petroleum products during the year under review.

**2.2.5 Procurement of Petroleum Products**

I have conducted a special audit on procurement of petroleum products by the Corporation during the period from 01 June 2011 to 30 June 2012 under the direction made by the Chairman of the Committee on Public Enterprises and the report had been tabled in Parliament in June 2013.

Accordingly, it was observed that the Corporation had sustained an estimated loss of Rs. 5.1 billion during the short period of 07 months from 01 June to 31 December 2011 due to inefficiencies such as lack of a comprehensive procurement plan, weaknesses in the procurement procedure, failure to carry out reliable laboratory tests on time, lack of coherence communication and preparedness to meet the challenge of a volatile market, overpayments, delays in planning orders for procurement of petroleum products, uneconomical blending of high and low octane petrol, etc. Such issues had created a negative impact on the reputation of the Corporation as well as the economy of the Country.

A brief summary of major issues highlighted in the above report relating to the year under review is given below.

| Description | Value | | | |
|---|---|---|---|---|
| | GBP | US$ | Ex. rate * Rs. | Rs. |
| Arbitration claims and legal cost payable due to cancellation of agreement entered into with a foreign ship broker | - | 750,246.83 | 127.1608 [1] | 95,401,987 |
| - Do - | 6,590 | - | 205.4728 [1] | 1,354,066 |
| Loss sustained by the Corporation as a result of allowing the supplier (A Singapore based oil company) to use "Platts" prices for any five days in B/L month (BK/52/2011, BK/53/2011, BK/56/2011, BK/58/2011, BK/59/2011) | - | 6,798,029.39 | 114.1444 [2] | 775,957,089 |
| Loss sustained by the Corporation due to deducting outturn quntity losses from invoice value of supplier (BK/10/2011) | - | - | - | 10,097,359 |
| Demurrage claimed by the suppliers due to operational inefficiencies and terminal constraints of Corporation | - | 795,393.71 | 127.1608 [1] | 101,142,900 |
| Demurrage claimed by other ships which had arrrived on time but unable to discharge due to delays in discharging process of the Corporation | - | 96,933.20 | 127.1608 [1] | 12,326,103 |
| Payment for procurement of contaminated Gasoline (92 Octane) (BK/17/2011) | - | 20,293,127.00 | 114.8172 [2] | 2,330, 000,000 |
| Payment made for damaged vehicles due to usage of contaminated fuel released to the market by the Corporation (BK/17/2011) | - | - | - | 28,000,000 |
| Loss sustained by the Corporation due to delays in signing agreement with the selected supplier to import of Fuel Oil, and as a result procurements made from other suppliers on urgent basis at higher premium to avoid power cuts. (BK/49/2011) | - | 521,500.00 | 127.1608 [1] | 66,314,357 |
| Loss sustained by the Corporation as a result of changing of quantity basis Air to Vacuum basis (BK/011/062) | - | 36,134.27 | 127.1608 [1] | 4,594,863 |

| | | | | |
|---|---|---|---|---|
| Loss sustained by the Corporation due to delays in making a decision for issuing Low Sulphur Fuel Oil (BK/45/2011) | - | - | - | 37,224,000 |
| Loss sustained by the Corporation due to sale of Auto Diesel instead of Low Sulphur Fuel Oil | - | - | - | 1,114,344,000 |
| Loss on under-estimation of six months fuel requirement and as a result of the procurement from the suppliers | - | 1,515,968.00 | 127.1608 [1] | 192,771,704 |
| Loss sustained by the Corporation due to non-compliance with the Cabinet decision to import petrol under term contracts and importing petrol on spot bid basis in which bid premium was much higher than the average premium of the previous couple of months. | - | 2,422,571.00 | 127.1608 [1] | 308,056,066 |
| The Corporation had sustained an estimated loss as a result of the cancellation of the first offer and refloating the bid. | - | 43,213.33 | 127.1608 [1] | 5,495,042 |
| **Total** | | | | **5,083,079,536** |

* Exchange rates:

*1. Exchange rates according to the Central Bank Reports as at 31 December 2012*

*(Daily Indicative Rates of World Currencies – 31.12.2012)*

| ***Country*** | ***Currency*** | ***Indicated Rate (Rs.)*** |
|---|---|---|
| *UK* | *Pounds* | *205.4728* |
| *USA* | *Dollars* | *127.1608* |

*2. Actual rates*

### 2.2.6 Assets Management

The following assets had been lying idle since the acquisition of those assets.

| Nature of the Asset | Observation |
|---|---|
| (a) Wanathamulla – Halgahakumbura Land | This land had been acquired for Rs.10.6 million for the purpose of LP Gas project and a playground. However, it had not been utilized for the purpose up to 31 August 2013. |
| (b) Mahena Land | According to the correspondence made available, the Corporation had paid a sum of Rs. 0.625 million for the acquisition of this land. However, this land had not been accounted in the books of the Corporation, and is being used by the previous owner since 1986. |

### 2.2.7 Budget

Significant variances were observed between the budget and the actual income and expenditure for the year under review, thus indicating that the budget had not been made use of as an effective instrument of management control.

## 3. Systems and Controls

Significant deficiencies observed in systems and controls during the course of audit were brought to the notice of the Corporation from time to time. Special attention is needed in respect of the following areas of control.

(a) Property, Plant and Equipment

(b) Debtors and Other Receivables

(c) Trade Creditors and Other Payables

(d) Accounting

(e) Compliance with Laws, Rules, etc.

(f) Procurements

(g) Utilization of Resources

(h) Human Resources Management

(i) Assets Management

(j) Payment of Bonus