Ceylon Petroleum Corporation and its Subsidiary (CPC) - 2013

The audit of financial statements of the Ceylon Petroleum Corporation (CPC) and the consolidated financial statements of the Corporation and its Subsidiary for the year ended 31 December 2013 comprising the statements of financial position as at 31 December 2013 and the statements of comprehensive income, statements of changes in equity and cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory information, 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 Section 13(1) of the Finance Act, No. 38 of 1971 and Section 31 of the Ceylon Petroleum Corporation Act, No. 28 of 1961. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2) (c) of the Finance Act appear in this report. The financial statements of the Subsidiary were audited by a firm of Chartered Accountants in public practice appointed by the Board of Directors of the respective Subsidiary. A detailed report in terms of Section 13(7) (a) of the Finance Act will be issued in due course.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Standards of Supreme Audit Institutions (ISSAI 1000 -1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgments, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements 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 Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2 Financial Statements

2.1 Qualified Opinion

(a) Qualified Opinion – Corporation

In my opinion, except for the effects of the matters described in paragraph 2.2.2 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 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(b) Qualified Opinion – Group

In my opinion, except for the effects of the matters described in paragraph 2.2 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 2013 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Group Financial Statements

The following observations are made.

(a) The auditors of the Ceylon Petroleum Storage Terminal Ltd (CPSTL), the Subsidiary of the Corporation having two third of shares, had expressed a qualified opinion on the financial statements for the year 2013 based on the followings matters.

(i) Even though excess terminal charges refundable to the Corporation and Lanka Indian Oil Company (LIOC) amounting to Rs. 1,065,397,574 and Rs. 120,238,623 respectively had been outstanding since 2008, no action had been taken to settle these amounts.

(ii) Related party confirmations received from the Corporation and LIOC were not in agreement with the amounts reflected in the ledger. Further, dues from the Corporation and LIOC amounting to Rs. 221.34 million and Rs. 3.35 million had been disputed.

(b) A sum of Rs. 461,046,341 receivable from the Subsidiary, which had been included in trade and other receivables for more than one year as at 31 December 2013, had not been eliminated in consolidation, and as a result, the trade and other receivables shown in the group financial statements for more than one year had been overstated by similar amount.

2.2.2 Financial Statements of the Corporation

2.2.2.1 Going Concern of the Corporation –

I draw attention to the matter that the Corporation had sustained net loss of Rs. 7,984 million for the year 2013 and had a negative net assets position of Rs. 236,529 million at the end of the year under review, and also, the negative impact of Hedging transactions taken place in 2012 had caused to increase the net loss of the Corporation. Even though the net loss of the year under review had decreased up to Rs. 7,984 million as compared with the net loss of Rs. 97,308 million for the previous year, occurring heavy losses since 2008 had resulted to further erosion of the net assets position of the Corporation. Thus, the ability of the Corporation to continue as a going concern without the financial assistance from the Government is doubtful.

2.2.2.2 Non-compliance with Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) According to the Sri Lanka Accounting Standards applied before 01 January 2012, the Group should have recognized the gain on acquisition of the CPSTL (Subsidiary) in profit or loss immediately. However, the business acquisition related gains of Rs. 2,485.6 million had not been recognized in profit or loss in accordance with Sri Lanka Accounting Standards and instead it had been shown continuously as a reserve in the consolidated statements of financial position of the Group since 2010.

(b) According to the Accounting Policy No. 3.2 referred in the financial statements, the Corporation had computed the retirement benefit costs by applying the **projected unit credit method** using the software issued by the Institute of Chartered Accountants of Sri Lanka, which had been permitted to use only for small and medium scale enterprises (SME). Accordingly, the requirement of provision for gratuity in terms of **LKAS 19 – Employee Benefits** had not been followed.

(c) According to the information made available, it was observed that there were 216 unsettled court cases as at the end of the year under review, and out of that 112 cases with expected amounts of Rs. 36,948,819, US dollars 13,309,645 and GBP 90,812 were against the Corporation and 18 cases were filed by the Corporation against the outsiders with expected amounts of Rs. 5,643,991,774, US Dollars 5,175,203 and GBP 13,901. Further, out of above mentioned 216 court cases, 189 cases were remained unsettled up to the date of this report. However, only three (3) cases filed by the Corporation against the outsiders had been disclosed under the Accounting Policies to the financial statements. Therefore, it was observed that an appropriate provisions or disclosures for legal obligations as at the end of the year under review had not been made in the financial statements as required by **LKAS 37 – Provisions, Contingent Liabilities and Contingent Assets**.

2.2.2.3 Accounting Deficiencies

The following observations are made.

(a) The stock of platinum (precious metal) used to prepare new catalysts, which was an integral component of the platformer unit of the Refinery, had represented a negative (credit) balance of Rs. 21,463,682 as at 31 December 2013 due to changing the accounting policy for valuation of platinum stock by the Corporation which had not been separately disclosed in the financial statements and making inappropriate adjustments to the balance of previously revalued amount of platinum stocks. Hence, the year-end balance of stocks shown in the financial statements had not been fairly reflected and the actual impact could not be ascertained due to unavailability of information for audit.

(b) The Corporation had utilized the oil stock of Rs. 7,346,782 owned by the LIOC and it had been deducted from the other receivables as at the end of the year under review. As a result, the other receivables as well as the balance of oil stock shown in the financial statements had been understated by similar amount.

(c) A sum of Rs. 383,114,031 payable to the Central Bank of Sri Lanka (CBSL) in respect of expenditure incurred for Hedging transactions of the Corporation and salaries payable to the employees of the Corporation amounting to Rs. 3,565,829 had been inappropriately included under the amounts payable to related parties. Further, a sum of Rs. 50 million of legal fees reimbursed to the CBSL on Hedging transactions had erroneously been accounted as legal fees for the year under review without being posted to the CBSL payable account. As a result, the payable balance to the CBSL and the legal fees shown in the financial statements had been overstated by similar amount.

(d) Dividend receivable from the Subsidiary amounting to Rs. 875 million had not been taken into the accounts of the Corporation, and as such, it had not been considered in consolidation as well.

(e) A difference of Rs. 796 million was observed between the outstanding balance shown in the financial statements of the Corporation as receivables from the Ceylon Electricity Board (CEB) and the corresponding balance shown in the financial statements of the CEB as payable to the Corporation. However, the CEB had refused for charging a sum of Rs. 766 million as interest for delay in payments, which had been included in the above balance, and ignoring that dispute the Corporation had accounted for it as receivable.

2.2.2.4 Unreconciled Differences

The following unreconciled differences were observed.

(a) Differences of Rs. 2,196.19 million and Rs. 3,371.95 million were observed between the related party balances shown in the financial statements of the Corporation and the corresponding balances shown in the financial statements of the Subsidiary for the years ended 31 December 2012 and 2013 respectively.

Similarly, sums of Rs. 2,297.82 million and Rs. 652.28 million of differences were observed between the financial statements of the Corporation and the Subsidiary in respect of the services for oil storage and distribution for the years ended 31 December 2012 and 2013 respectively.

(b) Balances shown in the financial statements of the Bank of Ceylon and the People's Bank as at 31 December 2013 had not been tallied with the corresponding balances shown in the financial statements of the Corporation. Accordingly, the differences of Rs. 1,202 million and Rs. 34 million respectively were observed between those financial statements.

2.2.2.5 Accounts Receivable and Payable

Total trade receivables as at 31 December 2013 was Rs. 53,189,676,188 including Rs.15,415,734,805 and Rs. 37,773,941,383 due from government institutions and private institutions respectively, and out of that a sum of Rs. 339,877,818 had been outstanding for more than 2 years.

The details of the outstanding balances of the Corporation as at 31 December 2013 as compared with the previous year are given below.

Category	**Total dues as at 31 December**	
	2013	**2012**
	Rs.	**Rs.**
Dealers	1,017,123,765	947,723,789
Aviation	34,725,218,564	29,887,871,353
Power Plants – CEB	7,154,095,254	27,823,749,142
Power Plants - Private	5,412,175,605	17,064,591,449
Government Consumers	2,617,900,530	20,776,542,402
Private Consumers	1,709,489,885	574,893,541
Agro Chemical	23,639,740	26,534,377
Lubricant	527,351,340	535,322,865
Others	2,681,505	74,544
Total	**53,189,676,188**	**97,637,303,460**

The following observations are also made in this regard.

(a) Out of total outstanding balance of Rs. 53,189,676,188 as at 31 December 2013, a sum of Rs. 280,420,496 was outstanding for more than 3 years and out of which several customers having outstanding balance of Rs. 231,027,426 had been continuously supplied petroleum products.

(b) As highlighted in my previous years audit reports, the Corporation had provided the credit facilities to two aviation customers without obtaining bank guarantees. The management's view on this regard was "there was no any credit risk as *Petronas* (an aviation customer) was a government owned Aviation Company settling its dues without any dispute". Nevertheless, the Corporation had made a full provision for the outstanding balance of Rs. 3,603,910 receivable from this company in the financial statements of the year under review.

(c) Instances of providing credit facilities exceeding bank guarantee during the under review to four aviation customers were observed. The extent of granting credit facilities exceeding the bank guarantees was between the ranges of 50 per cent to 121 per cent.

(d) The Corporation had provided the special credit facilities to a 5-Day Credit Dealer based on a special credit facilities provided during the war season and another 5-Day Credit Dealer based on a special request made by him without proper approval. Further, these credit facilities had been extended to a power plant customer on an agreement. However, continuation of these facilities over a longer period without considering the present environmental changes and obtaining the required approvals was in question to audit. Total amount outstanding from those customers as at 31 December 2013 was Rs. 1,863.7 million.

(e) According to the Board decision taken on 08 August 2006 and the letter dated 24 March 2008 of the Senior Deputy Finance Manager (Revenue) of the Corporation, an interest rate of 24 per cent per annum is required to be charged to the customers having overdue balances. However, the System Application and Products (SAP) system of the Enterprise Resource Planning (ERP) system introduced and implemented by the Subsidiary, which used by the Corporation for data processing and monitoring of stock levels, does not facilitate to calculate the interest charges on unsettled invoices over the credit period. Therefore, the Corporation had used to calculate the interest manually on unsettled invoices and to update the SAP System. Accordingly, it was observed that a proper system had not been designed, implemented and maintained by the Corporation to ensure the accuracy and completeness of interest charges on overdue balances.

(f) Petroleum products had continuously been supplied to defaulted Cheque on Delivery (COD) customers on hard cash basis until the settlement of the balances outstanding which reflects poor credit control. For instance, the value of defaulted COD in 2013 and 2012 were Rs. 64,942,385 and Rs. 58,399,795 respectively. There were 1,489 instances of cheque returns valued at Rs. 1,413,402,939 during the year 2013 as compared with 1,579 instances valued at Rs.1,388,713,962 during the year 2012, which was noted as an excessive amount. It was revealed that customers had used this practice to manage their own working capital due to lack of proper control in this regard.

(g) Out of the total trade receivables of Rs. 53,189.7 million as at 31 December 2013, a sum of Rs. 44,556.5 million due from 856 debtors had not been confirmed their balances. Further, a difference of Rs. 821.4 million was observed between the ledger balances and the balances confirmed by debtors. However, a statement of reconciliation or management explanation for the differences was not furnished to audit.

2.2.2.6 Hedging Transactions

According to the Hedging transactions, the Corporation was cited as a party in the arbitration proceeding pertaining to hedging contracts entered into with several commercial banks. As such, a sum of US Dollars 60 million (Rs. 7,612 million) had been paid to the Standard Chartered Bank (SCB) on 3 June 2013 under the Deed of Settlement entered into between the parties. According to the information made available, the total losses incurred by the Corporation as at 31 August 2014 including legal and other charges was Rs. 9,780 million.

In addition to that, the Central Bank of Sri Lanka had paid a sum of Rs. 378.7 million up to 31 December 2014 for the services obtained from the foreign lawyers who appeared in the arbitration proceedings initiated by the Deutsche Bank against the Government of Sri Lanka. However, this position and the amount had not been disclosed in the financial statements of the Corporation.

2.3 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance with Laws, Rules, Regulations and Management Decisions were observed.

	Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a)	Section 3.2 of the Public Enterprises Circular No. PED/12 of 2 June 2003 on Public Enterprises Guidelines for Good Governance	The Board of Directors of the Corporation had not been included a member in the field of Petroleum industry.
(b)	Finance 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, 16 employees had been appointed for covering duties of vacant posts for the period ranging 02 months to 02 years at the end of the year under review.

3 Financial Review

3.1 Financial Results

According to the financial statements presented, the operation of the Corporation for the year under review had resulted in a pre-tax loss of Rs. 7,733 million as compared with the corresponding pre-tax loss of Rs. 89,569 million for the preceding year, thus indicating an improvement of Rs. 81,836 million in the financial results. The main reasons for this improvement are summarized and shown below.

Description	For the year ended 31 December 2013	For the year ended 31 December 2012	Change Favorable/ (Unfavorable)	Percentage
	Rs. million	Rs. million	Rs. million	
Revenue	490,381	512,910	(22,529)	(4.4)
Cost of Sales	(467,638)	(573,692)	106,054	18.5
Gross Profit/(Loss)	**22,743**	**(60,782)**	**83,525**	**137.4**
Other Income	374	285	89	31.2
Selling and Distribution Expenses	(11,965)	(12,633)	668	5.29
Administration Expenses	3,600	5,801	2,201	37.9
Operating Profit	**7,552**	**(78,930)**	**86,482**	**109.6**
Finance Charges	(18,540)	(18,360)	(180)	(1)
Finance Income	3,255	7,721	(4,466)	(57.8)
Loss Before Income Tax	**(7,733)**	**(89,569)**	**81,836**	**91.4**
Hedging Expenses	(214)	(7,612)	7,398	97.2
Loss for the Year	**(7,984)**	**(97,308)**	**89,324**	**91.8**

The operations of the Corporation had resulted in a markup of 4.86 per cent for the year under review thus indicating an improvement of 15.45 per cent in financial results as compared with the negative markup of 10.59 per cent in the preceding year. Similarly, the gross profit for the year under review had increased by Rs. 83,525 million or 137 per cent as compared with the corresponding gross loss of Rs. 60,782 million in the preceding year. The increase in domestic sales prices of some petroleum products such as Petrol (Octane 92 and 95), Lanka Auto Diesel, Industrial Kerosene, and the decrease in quantity of domestic sales of loss making products such as Lanka Kerosene, Lanka Furnace Oil (3500), and Aviation Turbine Fuel-Loc, etc. had mainly attributed for the improvement in the financial results of the Corporation for the year under review.

The operations of the Subsidiary of the Corporation during the year under review had resulted in a pre-tax net profit of Rs. 1,596 million as compared with the corresponding pre-tax net profit of Rs. 2,193 million in the preceding year, thus indicating a decrease of Rs. 597 million in the financial results.

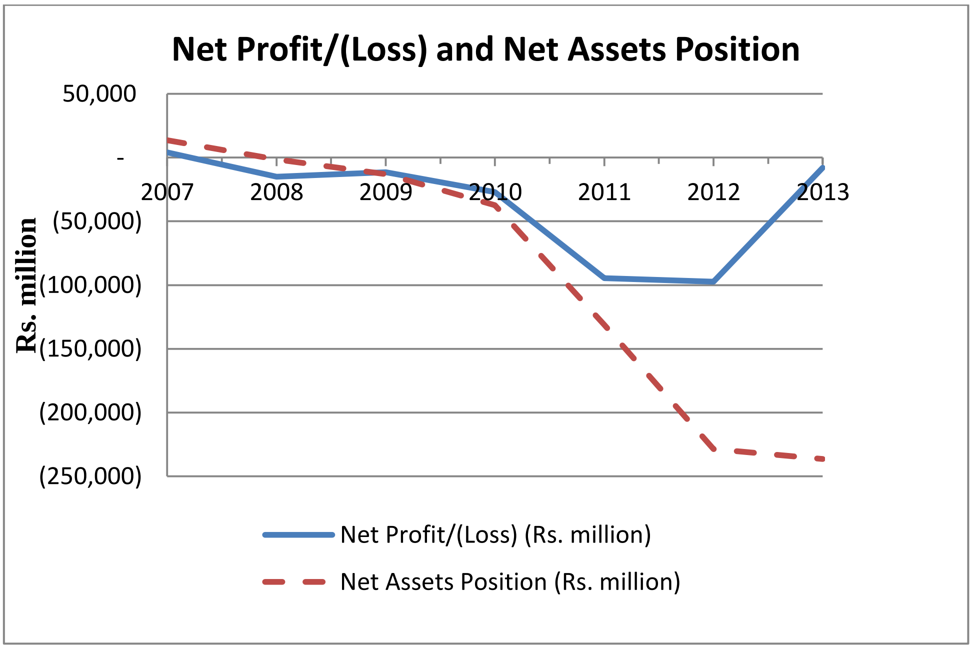
3.2 Analytical Financial Review

The following observations are made.

(a) Capital Erosion of the Corporation

The net profit/(loss) and the net assets position of the Corporation for the year 2013 and previous six years are depicted in the table and the chart given below.

Year	Profit/(Loss)	Net Assets Position as at the end of the Year
	Rs. Mn	Rs. Mn
2007	3,984	13,568
2008	(14,952)	(1,416)
2009	(11,353)	(13,038)
2010	(26,923)	(39,952)
2011	(94,503)	(131,324)
2012	(97,308)	(228,545)
2013	(7,984)	(236,529)



The main contributory factors for the continuous financial losses and capital erosion of the Corporation were revealed as inefficiency of refinery operations with low margin, poor yields and frequent stoppages, and as a result importation of refined petroleum products to meet the demand of the country, export of Naphtha and Furnace Oil 1500, the provision of fuel to Sri Lankan Airlines Ltd and Mihin Lanka (Pvt.) Ltd at concessionary rates which were lower than the contract customer price, heavy losses incurred on Hedging transactions, Corporation's increased borrowings from the banking sector to finance its oil bills, inefficiencies in procurement process of petroleum products, provision of furnace oil at subsidized rate to Ceylon Electricity Board (CEB), lack of proper stock level maintenance program and storage facilities, payment of demurrages etc.

Domestic retail prices of petroleum products had been revised upward in 2011, 2012 and 2013 in order to address these financial difficulties of the Corporation. At the meantime, the prices of both high sulfur and low sulfur fuel oil, used by the Ceylon Electricity Board for power generation had been increased by Rs. 25 per liter reaching the prices at Rs. 90 and Rs. 100 per liter respectively with effect from 01 April 2013. Major changes made by the Corporation in retail prices of petroleum products during the year 2013 with compared to the previous year are as follows.

Petroleum Products	**Price per Liter (Effective Date)**		**Price Increase (per Liter) During the Year**			
	14 Dec. 2012	**22 Feb. 2013**	**2012**		**2013**	
	Rs.	**Rs.**	**Rs.**	**Percentage**	**Rs.**	**Percentage**
Petrol 95 Octane	167.00	170.00	12.00	7.7	3.00	1.8
Petrol 90/92 Octane	159.00	162.00	22.00	16.1	3.00	1.9
Lanka Auto Diesel	115.00	121.00	31.00	36.9	6.00	5.2
Lanka Super Diesel	142.00	145.00	35.70	33.6	3.00	2.1
Lanka Industrial Kerosene	111.00	115.00	35.00	46.1	4.00	3.6

(b) Significant Accounting Ratios

According to the information made available some of the important ratios of the Corporation for the year under review and the preceding year are given below.

Ratios	**2013**	**2012**
Profitability Ratios		
Gross Profit Ratio (GP) (%)	4.64	(11.85)
Operating Profit Ratio (%)	1.54	(15.39)

Net Profit Ratio (NP) (%)	(1.63)	(18.97)
Liquidity Ratios		
Current Assets Ratio (Number of times)	0.32:1	0.41:1
Quick Assets Ratio (Number of times)	0.16:1	0.26:1
Working Capital (Rs. million)	(287,661)	(256,768)
Investment Ratios		
Return On Assets (ROA) (%)	(4.27)	(47.18)
Return On Capital Employed (ROCE) (%)	(3.38)	(42.58)

The following observations are made in this regard.

(i) The gross profit ratio and the net profit ratio for the year under review had been improved by 139 per cent and by 91 per cent respectively as compared with the previous year. The increase of selling prices of petroleum products in 2013 as mentioned above and decrease of crude oil import cost in line with international price trends was mainly attributed for this improvement.

(ii) The current asset ratio as well as the quick asset ratio had changed downward as compared with the previous year. Accordingly, the working capital position of the Corporation in 2013 had been further eroded as compared with the previous year. The main contributory factors for this decline were decrease of cash and cash equivalents and increase of the interest bearing loans and borrowings.

4 Operating Review

4.1 Performance

According to the Annual Report of the Central Bank of Sri Lanka for the year 2013, the total cost of importation of petroleum products (Crude Oil and Refined products) for the year 2013 was Rs. 535 billion and representing approximately 6.2 per cent of the Gross Domestic Product (GDP) of Rs. 8,674 billion in the year 2013 valued at current market prices. Further, it represented approximately 23 per cent of the total imports of Rs. 2,323 billion in the year 2013. According to the information made available to audit, the total contribution made by the Corporation for the above mentioned importation was Rs. 460 billion.

Even though the average price of crude oil imported had been declined and the domestic retail prices of petroleum products had been revised upward, the Corporation had continuously sustained losses from following petroleum products. Details are as follows.

Sector	Total Profits/(Losses) for the year ended 31 December		
	2013 Rs. million	**2012 Rs. million**	**2011 Rs. million**
Transport			
Lanka Auto Diesel	(6,235)	(29,654)	(62,045)
Power Generation			
Naphtha	(1,081)	(1,048)	(798)
Fuel Oil - 3500	(1,184)	(8,718)	(9,206)
Fuel Oil - 1500	(1,231)	(23,223)	(18,313)
Fuel Oil - 1500 (L/S)	(9)	(11,733)	(5,764)
Aviation			
Avteur - International	(1,251)	122	114
Industries			
Fuel Oil - 1500	(350)	(2,003)	(4,248)
Fuel Oil - 800	(333)	(904)	(1,790)
Ind. Kerosene	(126)	(364)	(832)
Lubricant Oil & Grease	(271)	46	217
Domestic			
LP Gas (K.G)	(436)	(377)	(224)
Kerosene	(2,449)	(3,525)	(6,886)
Farmers			
Agro Chemicals	(70)	(2)	(5)
Export			
Naphtha	(976)	(43)	(675)
Furnace 1500	(2,690)	(70)	(329)
Bunkering			
Diesel	(67)	-	-
Fuel Oil 1500	(729)	-	-

The above table presents the loss making products of the Corporation for the year 2013 with compared to previous two years. Accordingly, it was revealed that, other than Avteur – International in Aviation Sector, Lubricant Oil and Grease in Industries Sector, and Diesel and Fuel Oil 1500 in Bunkering Sector, all other products had been making losses continuously, while losses in Export sector had drastically increased in the year 2013 as compared with the previous year.

4.2 Management Inefficiency

The following observations are made.

(a) Enterprise Resource Planning (ERP) System

No proper evaluation of the risk involved in linking the Corporation data base to Enterprise Resource Planning (ERP) system developed by the Ceylon Petroleum Storage Terminal Ltd (CPSTL) with the assistance of the parent company of the Lanka

Indian Oil Company (LIOC), 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 any agreement or a Memorandum of Understanding (MoU) between the Corporation, CPSTL and LIOC with regard to their individual responsibilities under this Project before implementation. It was also important to have an agreement/MoU as a precautionary measure, taking into account the significant outlay of capital and human resources utilized by the Corporation, to be compatible with the ERP System introduced by the CPSTL.

(b) Provision of Fuel to Sri Lankan Airlines Ltd (SLA) and Mihin Lanka (Pvt) Ltd at Concessionary Rates

Even though Sri Lankan Airlines Ltd. (SLA) and Mihin Lanka (Pvt) Ltd. were contract customers, the Corporation had incurred losses of Rs. 669.77 million, Rs.456.6 million and Rs. 2,009.68 million during the years of 2011, 2012 and 2013 respectively, on sale of Aviation Turbine Fuel to the above companies at extraordinary concessionary prices. Details are as follows.

Name of the Company	**Loss incurred by the Corporation during the Year**					
	2013		**2012**		**2011**	
	US $ Mn	**Rs. Mn**	**US $ Mn**	**Rs. Mn**	**US $ Mn**	**Rs. Mn**
SriLankan Airlines Ltd	14.10	1,866.39	3.29	423.97	5.47	627.16
Mihin Lanka (Pvt.) Ltd	1.08	143.29	0.25	32.58	0.38	42.61
Total	**15.18**	**2,009.68**	**3.54**	**456.55**	**5.85**	**669.77**

Despite providing fuel at concessionary prices to those two companies, the settlement of outstanding fuel bills were very poor due to their weak financial performance i.e. as per the Annual Report of the Central Bank of Sri Lanka for the year 2013, Sri Lankan Airlines Ltd recorded an operational loss of Rs. 28.6 billion meanwhile Mihin Lanka recorded an operating loss of Rs. 1.5 billion in 2013. Trend of growing the outstanding balances since 2010 is given below.

Name of the Company	Outstanding Balance as at 31 December			
	2013	2012	2011	2010
	Rs. million	Rs. million	Rs. million	Rs. million
SriLankan Airlines Ltd	29,519.68	25,890.12	12,351.43	541.54
Mihin Lanka (Pvt.) Ltd	4,313.68	3,416.10	1,227.02	361.24

More than 64 per cent of total trade receivables amounting to Rs. 53,190 million as at 31 December 2013 were represented the trade receivables from above two companies. However, despite the weak financial performance of these companies, the Corporation had increased the credit limits as at 31 December 2013 from Rs. 28 billion to Rs. 35 billion for SriLankan Airlines Ltd and from Rs. 3.6 billion to Rs. 5 billion for Mihin Lanka (Pvt.) Ltd.

(c) Increase of Borrowings from the Banking Sector

The Corporation had increased its borrowings from the banking sector to finance its oil bills and it had also resulted to increase the losses and negative net assets position of the Corporation. Further, it was observed that the Corporation had continuously incurred huge finance cost during last consecutive four years as depicted below and shows an increasing trend.

Year	Bank Borrowings for the year ended 31 December	Annual Loss from Ordinary Activities	Finance Cost	Finance Cost as a Percentage of Loss from Ordinary Activities
	Rs. million	Rs. million	Rs. million	%
2010	168,020	26,923	6,859	26
2011	310,060	94,503	9,001	10
2012	399,520	89,569	18,360	21
2013	406,850	7,733	18,540	240

The Corporation had exceeded the indemnity limits fixed by the General Treasury to the commercial banks on behalf of the Corporation to secure the foreign currency loans as shown below.

Name of the Bank	Outstanding Amount as at 31 December 2013		Security – General Treasury Indemnity		Exceeded Amount over the Security	
	US $ million	**Rs. million**	**US $ million**	**Rs. million**	**US $ million**	**Rs. Million**
Bank of Ceylon	1,811	239,617	900	119,106	911	120,511
People's Bank	1,318	174,415	650	86,021	668	88,394

The Chairman of the Corporation stated in this regard as follows.

"Non-receipt of subsidy to cover up financial losses as per Section 17 of Finance Act, No. 38 of 1971 is the main reason for erosion of equity capital and negative net asset position. This situation was informed to the Secretary to the Ministry of Finance & Planning. However, interest rate reduction was granted to CPC due to General Treasury intervention in the year 2013. Further, the Government has agreed to provide Rs. 100 Bn. as equity finance in the budget 2015."

(d) Pipeline Network for Oil Transportation

The pipelines installed several decades back to transport of finished petroleum products such as petrol, diesel, kerosene and furnace oil from the Colombo Port to the Kolonnawa Petroleum Installation are in a state of repair and it was revealed that some of them have already been abandoned due to its' deteriorated condition beyond repairs. Renovation and modernization of those pipelines have been a very urgent need, as a large quantity of the national requirement of the petroleum products is being carried into Kolonnawa fuel Storage Terminal through those deteriorated pipelines. The possibility of paralyze the whole country with a severe fuel crisis due to transporting the imported finished petroleum products through those deteriorated pipelines could not be ruled out in audit.

The Muthurajawela installation is fed through a Single Point Buoy Mooring (SPBM) facility located in the mid sea about 6 km from the shore and 7.2 km from Muthurajawela Terminal and there was no alternative supply source in case of rough sea conditions or when the SPBM facility is under maintenance. At the same time, there was no linkage between the Muthurajawela Terminal and Kolonnawa Installation for inter-terminal product transfers and, which had also hampered the optimum utilization of those terminals due to those constraints.

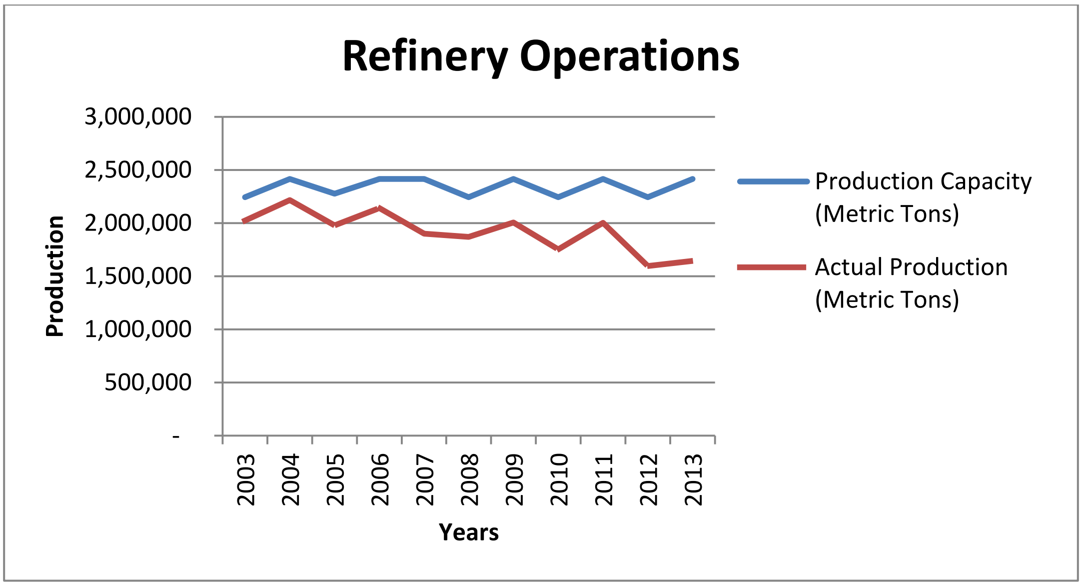
Even though, the approval of the Cabinet of Ministers for the implementation of "Cross Country Pipeline Project" had been granted on 13 September 2012, it has not yet been implemented.

4.3 Operating Inefficiencies

Approximately one third of the country demand of petroleum products are met from the Corporation owned refinery located at Sapugaskanda. The lower refinery yields and operational failures associated with the delays in modernization and lack of expansion of the refinery had negatively affected to the financial performance of the Corporation.

Even though the volume of crude oil refined (intake) by the Corporation had increased to 1,643,218 metric tons in 2013 as compared with 1,596,058 metric tons in 2012, the processing levels had not reached the production capacity of 6,900 tons per stream day or 2,415,000 metric tons in the year 2013. The Crude Oil intake for the year 2013 and previous ten years as compared with the production capacity for the respective years is as follows.

Year	**Quantity of Crude Oil Intake (processed) for the Production (MT)**		**Difference**	
	Available Capacity	**Actual Utilization**	**Quantity (MT)**	**Percentage**
2013	2,415,000	1,643,218	771,782	31.96
2012	2,242,500	1,596,058	646,442	28.83
2011	2,415,000	2,003,607	411,393	17.03
2010	2,242,500	1,752,716	489,784	21.84
2009	2,415,000	2,005,915	409,085	16.94
2008	2,242,500	1,870,237	372,263	16.60
2007	2,415,000	1,899,079	515,921	21.36
2006	2,415,000	2,140,132	274,868	11.38
2005	2,277,000	1,977,751	299,249	13.14
2004	2,415,000	2,216,646	198,354	08.21
2003	2,242,500	2,023,605	218,895	09.76



The existing 45 years old refinery, which was commissioned in 1969, is not able to cater the increasing demand of petroleum products in the country and this refinery is operating with low margin when compared with the modern world refineries operating with advanced technologies including facilities to produce petroleum products at lower cost whereby maximizing the refinery operating efficiency. However, the Corporation was not yet able to implement the proposed Sapugaskanda Oil Refinery Expansion and Modernization (SOREM) Project in order to ensure that petroleum products are supplied to the market in a cost effective manner.

4.4 Matters in Contentious Nature

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Excess terminal charges paid to the Ceylon Petroleum Storage Terminal Ltd during the year 2009 to 2013 amounting to Rs. 1,065.4 million and shown in the financial statements of the Company had not been brought to the accounts of the Corporation as the Company had not taken a decision to pay back that amount to the Corporation.

4.5 Assets Management

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

(a) Halgaha Kumbura Land at Wanathamulla

This land had been acquired by spending Rs.10.6 million for the purpose of LP Gas Project and a Playground.

(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.

(c) Investments

The caring value of the investment made in quoted and unquoted shares of four companies as at 31 December 2013 was Rs. 38.636 million. However, any dividend since longer period had not been received to the Corporation thereon. Further, the Corporation does not aware the existence of the International Cooperative Petroleum Association having investment value of Rs. 5 million.

4.6 Resources Released to Other Institutions

The Section 8.3.9 of the Department of Public Enterprises Circular No. PED/12 of 2 June 2003 on Public Enterprises Guidelines for Good Governance is not permitted to incur expenditure or deploy its resources under any circumstances, on behalf of the line Ministry or any other Government Institution. However, the Corporation had released the following resources to other institutions and incurred over a sum of Rs. 46 million as remuneration and maintenance expenses during the year 2013. Details are shown below.

Type of Resource	**Number**	**Cost Incurred**
		Rs.
Human Resources	44	41,980,142
Vehicles	07	4,461,920
Total		**46,442,062**

4.7 Human Resources Management

The approved and actual cadre of the corporation as at 31 December 2013 was 3,284 and 2,581 respectively. Details are given below.

Staff Category	**Approved Cadre**		**Actual Cadre**						**Number of Vacancies**	
	2013	**2012**	**2013**			**2012**			**2013**	**2012**
			Permanent	**Contract Basis**	**Total**	**Permanent**	**Contract Basis**	**Total**		
Senior	446	372	293	03	296	300	01	301	153	72
Secondary	1,478	1,286	1,245	01	1,246	1,277	11	1,288	233	09
Primary	1,360	1,347	1,033	06	1,039	1,060	10	1,070	327	287
Total	**3,284**	**3,005**	**2,571**	**10**	**2,581**	**2,637**	**22**	**2,659**	**713**	**368**

The following observations are made in this connection.

(a) Out of 713 vacant posts, 34 per cent represent the vacancies existed in the senior staff level (including Commercial Manager and Deputy General Manager - Marketing) and running the entity having such a huge vacancies without any impact to its main operational activities was questionable to audit.

(b) Ten posts in all categories have been filled on contract basis and the Chief Internal Auditor had been acting in the post of Deputy General Manager (Finance) since mid of 2011.

(c) Adequate actions had not been taken to fill the vacancies existed by 31 December 2013.

5. Budgetary Control

Significant variances were observed between the budgeted 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.

6. Systems and Controls

The 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) Trade and Other Receivables
(b) Trade and Other Payables
(c) Accounting and Financial Management
(d) Procurement
(e) Utilization of Resources
(f) Human Resources Management
(g) Assets Management