Ceylon Petroleum Corporation (CPC) and its Subsidiary - 2014

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 2014 comprising the statements of financial position as at 31 December 2014 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.

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 2014 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 2014 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 interests, had expressed a qualified opinion on the financial statements for the year under review based on the following matter.

The audited financial statements of the Ceylon Petroleum Corporation Thrift Society Limited for the year ended 31 December 2014 had not been received even up to 31 August 2015. However, according to the audited financial statements for the year ended 31 December 2013, the Company had recorded a negative unrestricted reserve balance of Rs. 1,254,783,349 which resulted in negative accumulated reserves of Rs.580,812,190. Nevertheless, the Company had stated that the activities would not be affected by the above negative reserve position, and the Company was able to continue its activities for the foreseeable future.

(b) In addition to the above qualification, the auditors of the CPSTL had drawn attention to the followings matters:

(i) As disclosed in note 4 to the financial statements, the Memorandum of Understanding (MOU) for the common user facility entered into between the Ceylon Petroleum Corporation, Lanka Indian Oil Company PLC and the Ceylon

Petroleum Storage Terminals Limited had expired on 31 December 2008. Nevertheless, the renewal or extension of the MOU had not been finalized and the income and expenses as stated in the MOU had been accounted in the financial statements after considering the conditions in the aforesaid MOU and any subsequent changes which had been approved by the Board of Directors of the CPSTL. In the absence of a valid MOU, uncertainty existed that a finalized MOU at a future date could be implemented with a retrospective effect, in which case the reported results could be materially misstated.

(ii) According to the Note - 14.1 to the financial statements, based on the confirmations received, the amounts due from related parties were disputed by Rs. 135 million for which an allowance for impairment had been made in the financial statements.

(iii) As described in Note 5 to the financial statements, the CPSTL had incurred a loss of Rs. 473.82 million (Loss for the year 2013 was Rs. 526 million) from transportation of petroleum products and earned a gain of Rs. 150.08 million (Loss for the year 2013 was Rs. 117.76 million) on loan interest reimbursements.

(c) Out of the disputed balance mentioned in paragraph 2.2.1(b) (ii) above, a sum of Rs.129 million was still receivable from the Ceylon Petroleum Corporation.

(d) Intercompany receivable and payable balances as at 31 December 2014 between the Corporation and the CPSTL had not been separately disclosed in the consolidated financial statements.

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 a negative net assets position of Rs. 231,532 million at the end of the year under review, although the operations of the Corporation had resulted in a pre-tax net profit of Rs. 1,854 million for the year under review. Further, the negative impact of heavy losses incurred by the Corporation due to Hedging transactions taken place in 2012 had caused to increase the net losses for previous years. Even though the financial performance of the Corporation had improved during the year under review, the heavy losses sustained since 2008 had led to a negative net assets position continuously. Thus, the ability of the Corporation to continue as a going concern without the financial assistance from the Government is in doubtful.

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

The following observations are made.

(a) LKAS 1 – Presentation of Financial Statements

A sum of US Dollars 121.17 million receivable from Sri Lankan Airlines Ltd. had been converted to a loan on 05 July 2012 at the interest rate of 4 per cent plus LIBOR in USD terms, payable quarterly within 4 years, in order to settle the outstanding balance of trade receivables to the Corporation by them. However, the relevant current and noncurrent assets portions of that loan balance as at 31 December 2014 had not been shown separately in the financial statements as specified in the Standards.

(b) LKAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors.

Dividends declared by the CPSTL prior to the year 2012 amounting Rs. 437.5 million, which had not been brought to the accounts of the Corporation, had been treated as an other operating income of the year under review instead of being treated as prior period items.

(c) LKAS 19 – Employee Benefits

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 is permitted to use only for small and medium scale enterprises (SME). Accordingly, the requirement of provision for gratuity in terms of the Standard had not been followed.

(d) LKAS 37 – Provisions, Contingent Liabilities and Contingent Assets

(i) According to the information made available, it was observed that there were 203 unsettled Court cases as at the end of the year under review, and out of that, 108 cases were filed by the outsiders against the Corporation claiming of Rs. 40,519,746, US Dollars 21,990,231, GBP 12,595 and Euro 74,817, while 14 cases were filed by the Corporation against the outsiders claiming of Rs. 5,464,489,715 and US Dollars 352,794. Further, out of the above mentioned 203 Court cases, 197 cases were remained unsettled up to 30 June 2015. However, only seven (7) cases filed by the outsiders against the Corporation had been disclosed (without amounts claimed) under the Accounting Policies to the financial statements. Accordingly, 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 the Standards.

(ii) In terms of general conditions of the agreements entered into between the Corporation and suppliers of petroleum products, the successful bidder was fully responsible to deliver the cargo within the agreed laycan period and any failure to comply with that, the supplier was liable for a penalty of 0.04 per cent of the DES value per day for each day of delay. Accordingly, a penalty of US Dollars 383,537.7 equivalent to Rs. 50,074,682 had been imposed to the petroleum suppliers during the year under review by the Corporation. However, the necessary accounting treatments in the books of accounts of the Corporation for those penalties or required disclosures in the financial statements had not been made as required by the Standards.

2.2.2.3 Accounting Deficiencies

The following observations are made.

(a) When compared the income on services for oil storage and distribution amounting to Rs. 10,185.5 million shown in the financial statements of the CPSTL with the corresponding expenditure (throughput and transport charges) amounting to Rs.9,772.6 million shown in the financial statements of the Corporation, a difference of Rs. 412.9 million was observed. However, in consolidation process, only a sum of Rs. 9,772.6 million had been eliminated without being reconciled these two amounts, and as a result, the terminal charges and other income shown in the consolidated comprehensive income statement for the year under review had been overstated by Rs. 412.9 million.

Further, the terminal charges amounting to Rs. 1,065.4 million paid excessively by the Corporation to the CPSTL during the period from 2005 to 2007, had not been recognized as receivable in the respective financial statements of the Corporation and a decision taken in 2014 to recover that amount from the terminal charges payable to the CPSTL. However, it had been erroneously credited to the terminal charges expenditure account of the year under review. As a result, the operating profit of the year under review had been overstated by similar amount.

Moreover, the adjustments made in the financial statements of the Corporation for the terminal charges amounting Rsbeen . 1,065.4 million as referred above had not been adjusted in the financial statements of the CPSTL and as such, the intercompany transactions would have not been eliminated in the group financial statements.

(b) According to the information made available for audit, it was observed that a sum of US Dollars 1,795,798.7 had been claimed by the fuel suppliers as demurrages and of that, a sum of US Dollars 1,398,764.8 equivalent to Rs. 182,622,732 had been agreed to be paid by the Corporation in the year 2014. However, this obligation had not been recognized in the financial statements of the Corporation for the year under review, which resulted to overstate the profit of the year under review while understating the trade and other payable balance as at 31 December 2014 by Rs. 182,622,732. Further, the contingent liability relating to the balance amount of demurrages claimed by the fuel suppliers, but not finalized by the Corporation at the end of the year 2014, had not been disclosed in the financial statements.

(c) Amounts due to related parties and accrued expenses shown in the financial statements of the Corporation had been understated and overstated each by Rs. 281 million respectively due to a classification error.

(d) When analysis of the trade receivable and payable balances shown in the individual financial statements of the Corporation and the Ceylon Electricity Board (CEB) in respect of fuel supply and purchases as at 31 December 2014, a difference of Rs. 9,112,147 was observed between those figures. It was observed that this was due to shortage in delivery of fuel to the CEB. Further, action had yet not been taken to adjust this in the financial statements of the Corporation after proper investigation.

(e) Commitments to the Banks on Letter of Credits (LCs) and Acceptance relating to the importation of petroleum products as at 31 December 2014 aggregating US Dollars

1,033 million equivalent Rs. 137,843 million had been omitted in the financial statements of the Corporation.

2.2.2.4 Accounts Receivable and Payable

Total trade receivables as at 31 December 2014 was Rs. 37,059,955,539 including Rs.6,077,704,933 and Rs. 30,982,250,606 due from government institutions and private institutions respectively.

The details of the outstanding balances of the Corporation as at 31 December 2014 as compared with the previous year are given below.

Category	Total Receivables as at 31 December	
	2014	**2013**
	Rs.	**Rs.**
Dealers	729,257,403	1,017,123,765
Aviation	22,938,329,447	34,725,218,564
Power Plants – CEB	3,087,458,385	7,154,095,254
Power Plants – Private	2,013,089,325	5,412,175,605
Government Consumers	2,990,246,548	2,617,900,530
Private Consumers	529,231,709	1,709,489,885
Agro Chemical	24,549,928	23,639,740
Lubricant	529,665,978	527,351,340
Bunkering Business	1,664,776,859	-
Estate	1,123,496	-
Export	2,552,226,462	-
Others	-	2,681,505
Total	**37,059,955,539**	**53,189,676,188**

The following observations are made in this regard.

(a) Instances of providing credit facilities exceeding bank guarantee values during the year under review to twenty one 2-day credit dealers (due to delays in banking of cheques by the terminals and depots), four power plant customers and eight aviation customers were observed.

(b) 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. The total amount of special credit facilities provided during the year under review and the outstanding amount as at 31 December 2014 were Rs. 52,704.5 million and Rs. 23,948 million respectively.

(c) 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 CPSTL, 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 charges 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.

2.2.2.5 Hedging Transactions

The following observations are made in this regard.

(a) 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 and 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 December 2014 including the travelling expenses of Rs. 5,261,827 was Rs. 9,780 million.

(b) The Central Bank of Sri Lanka (CBSL) had incurred the legal expenses of Rs. 570.6 million with regard to Hedging transactions of the Corporation and out of that a sum of Rs. 567.5 million had already been reimbursed to the CBSL during the period from the year 2011 to 2014. In addition to that, the CBSL had paid a sum of Rs. 378.7 million up to 31 December 2014 for the services obtained from the foreign lawyers who had appeared in the arbitration proceedings initiated by the Deutsche Bank against the Government of Sri Lanka.

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

The following instances of non-compliances with Laws, Rules, Regulations and Management Decisions, etc. were observed in audit.

	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, 29 employees, appointed for covering up duties, had worked in those vacant posts for the period ranging 05 months to 04 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 net profit of Rs. 1,854 million as against with the pre-tax net loss of Rs. 7,889 million in the preceding year, thus indicating an improvement of Rs.9,743 million in the financial results. Accounting of kerosene subsidy amounting to Rs.2,715 million as an income of the year under review and the decrease of finance cost by Rs. 4,578 million, improvement of efficacy in the procurement process of petroleum products of the Corporation, etc. were the main reasons 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. 2,188 million as compared with the corresponding pre-tax net profit of Rs. 1,602 million in the preceding year, thus indicating an increase of Rs.587 million in the financial results.

3.2 Analytical Financial Review

The following observations are made.

(a) Profitability

The operations of the Corporation had resulted in a markup of 4.88 per cent for the year under review thus indicating an improvement of 0.02 per cent in financial results as compared with the markup of 4.86 per cent in the preceding year. Similarly, the gross profit for the year under review had increased by Rs. 1,703 million or 7.5 per cent as compared with the corresponding gross profit of Rs. 22,744 million in the preceding year. These improvements are summarized and shown below.

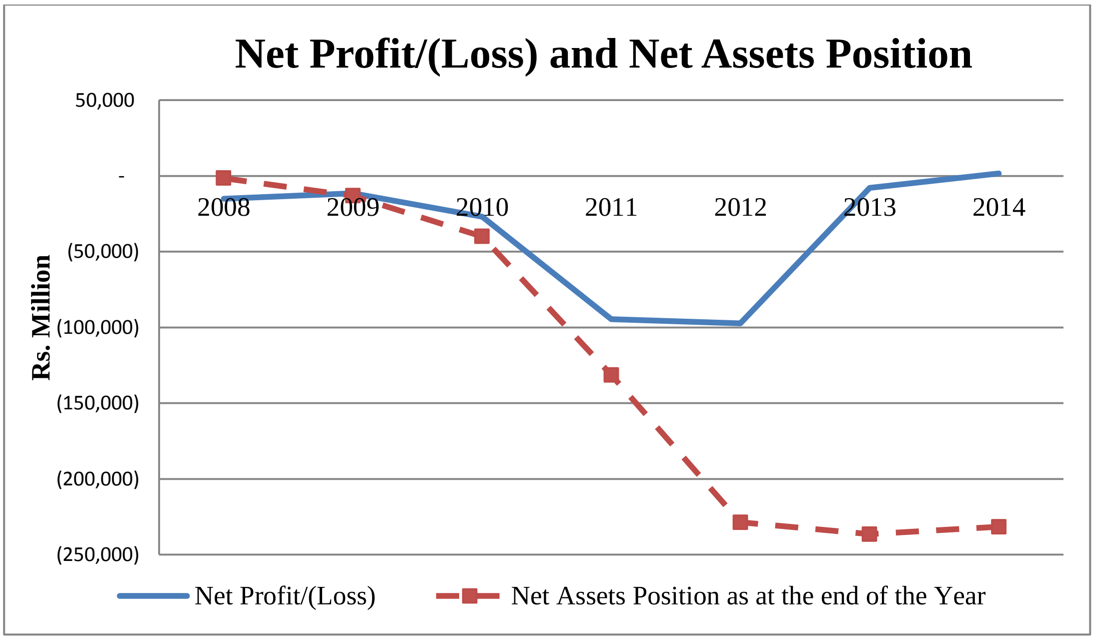
Description	**For the year ended 31 December**		**Change [Favorable/ (Unfavorable)]**	**Percentage**
	2014	**2013**		
	Rs. million	**Rs. million**	**Rs. million**	
Revenue	525,182	490,381	34,801	7.1
Cost of Sales	(500,735)	(467,638)	(33,097)	(7.1)
Gross Profit	**24,447**	**22,744**	**1,703**	**7.5**

Other Income	3,866	374	3,492	934
Selling and Distribution Expenses	(11,533)	(11,965)	432	3.6
Administration Expenses	(4,922)	(3,765)	(1,157)	(30.7)
Operating Profit	**11,858**	**7,388**	**4,470**	**60.5**
Finance Charges	(13,962)	(18,540)	4,578	24.7
Finance Income	3,957	3,262	695	21.3
Profit/(Loss) Before Income Tax	**1,854**	**(7,889)**	**9,743**	**123.5**

(b) Net Profit/(Loss) Vs Net Assets

The pre-tax net profit/ (loss) and the net assets position of the Corporation for the year 2014 and previous six years are depicted in the table and the chart given below.

Year	Net Profit/(Loss)	Net Assets Position as at the end of the Year
	Rs. Mn	Rs. Mn
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	(7,926)	(236,467)
2014	1,741	(231,532)



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 at the price below the refined cost, 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 and incurred huge interest costs thereon, inefficiencies in procurement process of petroleum products, provision of fuel (Furnace Oil and Naphtha) at subsidized rate to Ceylon Electricity Board (CEB), lack of proper fuel stock levels, poor maintenance of storage facilities, payment of demurrages to the suppliers, depreciation of the Rupee value continuously against the US Dollar, etc.

Even though the domestic retail prices of petroleum products had been revised upward continuously up to September 2014 in order to address these financial difficulties of the Corporation, the prices had been reduced twice during the year under review in line with decrease of international fuel price. However, effective pricing strategy reflecting the international oil price movements and aligning with Government objectives had not been designed and implemented by the Corporation. Major changes made by the Corporation in retail prices of petroleum products during the year 2014 are as follows.

Petroleum Products	**Price per Liter with effect from**		
	23 Feb. 2013	**23 Sep. 2014**	**05 Dec. 2014**
	Rs.	**Rs.**	**Rs.**
Petrol 95 Octane	170.00	165.00	158.00
Petrol 92 Octane	162.00	157.00	150.00
Lanka Auto Diesel	121.00	118.00	111.00
Lanka Super Diesel	145.00	140.00	133.00
Lanka Kerosene	106.00	86.00	81.00
Lanka Industrial Kerosene	115.00	115.00	110.00

(c) Significant Accounting Ratios

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

Ratios	**2014**	**2013**
Profitability Ratios		
Gross Profit Ratio (GP) (%)	4.66	4.64
Operating Profit Ratio (%)	2.26	1.51
Net Profit Ratio (NP) (%)	0.35	(1.61)
Liquidity Ratios		
Current Assets Ratio (Number of times)	0.39:1	0.39:1

Quick Assets Ratio (Number of times)	0.23:1	0.24:1
Working Capital (Rs. million)	(252,233)	(257,124)
Investment Ratios		
Return on Assets (ROA) (%)	0.95	(4.23)

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 0.02 per cent and by 1.95 per cent respectively as compared with the previous year.

(ii) The working capital position of the Corporation in 2014 was slightly stronger as compared with the previous year. The main contributory factors for this enhancement were increase of short term investments and cash and cash equivalents, and decrease of the trade and other payables.

4 Operating Review

4.1 Performance

According to the Annual Report of the Central Bank of Sri Lanka for the year 2014, the total cost of importation of petroleum products (Crude Oil and Refined products) for the year 2014 was Rs. 600 billion and it representing approximately 6.1 per cent of the Gross Domestic Product (GDP) of Rs. 9,785 billion in the year 2014 valued at current market prices. Further, it represented approximately 24 per cent of the total imports of Rs. 2,535 billion in the year 2014.

Even though the average price of crude oil imported had been declined and the domestic retail prices of petroleum products had been revised upward (up to September 2014), the Corporation had continuously sustained gross loss from following petroleum products.

Sector	**Gross Losses Sustained for the Year**			
	2014	**2013**	**2012**	**2011**
	Rs. Million	**Rs. Million**	**Rs. Million**	**Rs. Million**
Power Generation				
Naphtha	413	1,081	1,048	798
Domestic				
LP Gas (K.G)	312	436	377	224
Kerosene	1,775	2,449	3,525	6,886
Export				
Naphtha	1,700	976	43	675
Furnace 1500	1,530	2,690	70	329

Bunkering				
Diesel	168	67	-	-
Fuel Oil 1500	1,123	729	-	-
Fuel oil 3500	19	-		

At the meantime, the Corporation had continuously sustained net losses from the following petroleum products as compared with the previous years.

Sector	Net Losses Sustained for the Year		
	2014	2013	2012
	Rs. Million	Rs. Million	Rs. Million
Transport Sector			
Diesel	5,759	6,235	29,654
Power Generation			
Fuel Oil 1500	299	1,240	34,959
Naphtha	1,078	1,081	1,047
Aviation			
Jet Fuel	1,387	1,251	475
Industrial & Domestic			
Industrial Kerosene	71	126	364
Fuel Oil 1500	69	350	2,003
Domestic Kerosene	2,715	2,449	3,525
LP Gas	431	436	482
Export			
Naphtha	1,799	-	-
Fuel Oil	1,627	-	-
Bunkering			
Diesel	240	-	-
Fuel Oil 1500	1,392	-	-

The above tables present the loss making products of the Corporation for the year 2014 as compared with previous two years. Accordingly, it was observed that, all the above mentioned products, other than export and bunker operation commenced in 2014, had been making losses continuously, and all of such losses had adversely impacted to the financial performance and the financial position of the Corporation.

4.2 Management Inefficiency

The following management inefficiencies were observed.

(a) Enterprise Resource Planning (ERP) System

It was observed that there was no any agreement or a Memorandum of Understanding (MoU) among the Corporation, Ceylon Petroleum Storage Terminal Ltd (CPSTL) and Lanka Indian Oil Company (LIOC) with regard to their individual responsibilities in respect of the involvement of the Enterprise Resource Planning (ERP) System introduced by the CPSTL, and as such this system is not adequately utilized, especially for the fuel stock reviewing purposes.

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

Even though SriLankan 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, Rs. 2,009.68 million and Rs. 1,903.38 million during the years of 2011, 2012, 2013 and 2014 respectively, on sale of Aviation Turbine Fuel to the above companies at extraordinary concessionary prices. The details are given below.

Name of the Company	Loss incurred by the Corporation during the Year			
	2014	2013	2012	2011
	Rs. Million	Rs. Million	Rs. Million	Rs. Million
SriLankan Airlines Ltd	1,762.27	1,866.39	423.97	627.16
Mihin Lanka (Pvt.) Ltd	141.11	143.29	32.58	42.61
Total	**1,903.38**	**2,009.68**	**456.55**	**669.77**

Despite providing fuel at concessionary prices to those two companies, the settlement of outstanding fuel bills were also 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 2014, the SriLankan Airlines Ltd had recorded an operational loss of Rs. 29 billion meanwhile the Mihin Lanka (Pvt.) Ltd had recorded a marginal operating profit of Rs. 652 million. The trend of the outstanding balances since 2010 is given below.

Name of the Company	Outstanding Balance as at 31 December				
	2014	**2013**	**2012**	**2011**	**2010**
	Rs. Million	**Rs. Million**	**Rs. Million**	**Rs. Million**	**Rs. million**
SriLankan Airlines Ltd	20,900.35*	29,519.68*	25,890.12*	12,351.43	541.54
Mihin Lanka (Pvt.) Ltd	1,338.73	4,313.68	3,416.10	1,227.02	361.24

*The outstanding loan balance of Rs. 14,726.6 million, Rs. 10,020 million and Rs. 6,391 million as at 31 December 2012, 2013 and 2014 respectively as mentioned in paragraph 2.2.2.2(a) above had been included in these balances.

More than 60 per cent of the total trade receivable balance of Rs. 37,060 million as at 31 December 2014 was represented the trade receivable balance outstanding from the above mentioned two aviation companies.

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

"As Sri Lankan Airlines Ltd. and Mihin Lanka (PVT) Ltd. are national carriers, supply of fuel continued on the instructions of the Government."

(c) Increase of Borrowings from the Banking Sector

The Corporation had obtained its borrowings from the Banking sector in order to finance its oil bills and it had also resulted to decrease profits and sustain negative net assets position of the Corporation. Further, it was observed that the Corporation had continuously incurred huge finance cost during the last consecutive five years due to maintaining the significant amount of borrowings as depicted below.

Year	Bank Borrowings for the year ended 31 December	Finance Cost
	Rs. Million	**Rs. Million**
2010	168,020	6,859
2011	310,060	9,001
2012	399,520	18,360
2013	406,850	18,540
2014	376,607	13,962

The Chairman of the Corporation stated in this regard as *"non-receipt of subsidy to cover up financial losses is a major contributory factor for borrowings from the banking sector."*

(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 the 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 paralyzing the whole country with a severe fuel crisis due to transporting the imported finished petroleum products through those deteriorated pipelines cannot 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, 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.

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

"CPSTL is entrusted with replacement and maintenance of pipeline structures. There are three pipelines which are used for transferring products from Colombo Port to Kolonnawa Installation. 14″ line is dedicated for transferring black oil and other two lines are 12″ dia. and 10″ dia. respectively. Out of these two, 12″ dia. line was badly deteriorated over the past period. In the year 2015, this pipeline was refurbished by 50% and balance work is being carried out. As a result of this, no pipeline leakage is reported in the year 2015. 10″ dia. white oil line is in sound condition. However, a fresh Cabinet approval was received to enhance the diameter of existing white oil pipeline and replacement of existing pipeline infrastructure. Action will be taken to replace such lines in future.

Integration of Muthurajawela Terminal and Kolonnawa Installation would be considered in future capital projects listed in 2015 – 2020 capital budget under CPSTL."

(e) Fisheries Coupon System

Fisheries coupon system had been introduced in the year 2012 by the Government and it had been implemented by the Department of Fisheries and Aquatic Resources in collaboration with the Ceylon Petroleum Corporation and the General Treasury in view of facilitate the fishermen to purchase fuel at affordable prices. However, the expected outcome of that programme could not be able to achieve due to poor control over implementation of that coupon system. Therefore, The Government had stopped that system in September 2013 due to misuse and malpractices done by the fishermen, fuel dealers and certain other persons involved in implementation of the system. Some of such deficiencies observed in audit are given below.

(i) A sum of Rs. 23,790,125 claimed by the dealers had been hold by the Corporation due to various reasons such as fraudulent coupons attached with the claims, duel claiming, etc.

(ii) The Corporation had reimbursed a sum of Rs. 3,049,375 to the dealers based on duplicated and fraudulent coupons.

(iii) A sum of Rs. 1,090,175 had been paid to a dealer in excess of the amount claimed during the period from 20 July 2012 to 30 April 2013.

(iv) An amount of Rs. 176,091,436 had been excessively reimbursed to the Corporation by the Department of Fisheries and Aquatic Resources on 31 December 2013. However, this was not settled even up to end of the year under review, and it had been included under the trade and other payables in the financial statements of the Corporation for the year under review.

(f) Bunkering Business

The loss incurred from issuing of fuel oil 1500, which generated through the crude oil processing system of the Refinery to licensed bunker brokers during the year under review was Rs. 1,276.6 million and the amount receivable from those brokers as at 31 December 2014 was Rs. 1,664.8 million. The following observations are made in this regard.

(i) There was no proper plan to handle this product more economically to avoid the losses to the Corporation. The loss incurred in 2014 by selling of 54,796 Metric Tons and 44,138 metric tons to local and foreign customers were Rs. 1,276.6 million (loss per Metric Ton was Rs. 23,296) and Rs. 3,219.2 million (loss per Metric Ton was Rs. 72,936) respectively.

(ii) Any marketing promotions for improving the bunkering fuel business had not been carried out.

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

"CPC was forced to sell bunker fuel in the export market due to low demand in the country, especially for fuel oil was not used for power generation. During the year 2014, international finished petroleum product prices had drastically come down. But, CPC was able to sell the excess fuel oil at MOPS + premium ranging from US$ 26 – 30 per Metric Ton. However, international market fuel oil price was based on discount on MOPS. Failure to upgrade CPC refinery is a major reason for producing furnace oil. Since the cost of locally refined furnace oil is higher, a loss was reported. This speaks of urgent necessity of the refinery modernization.

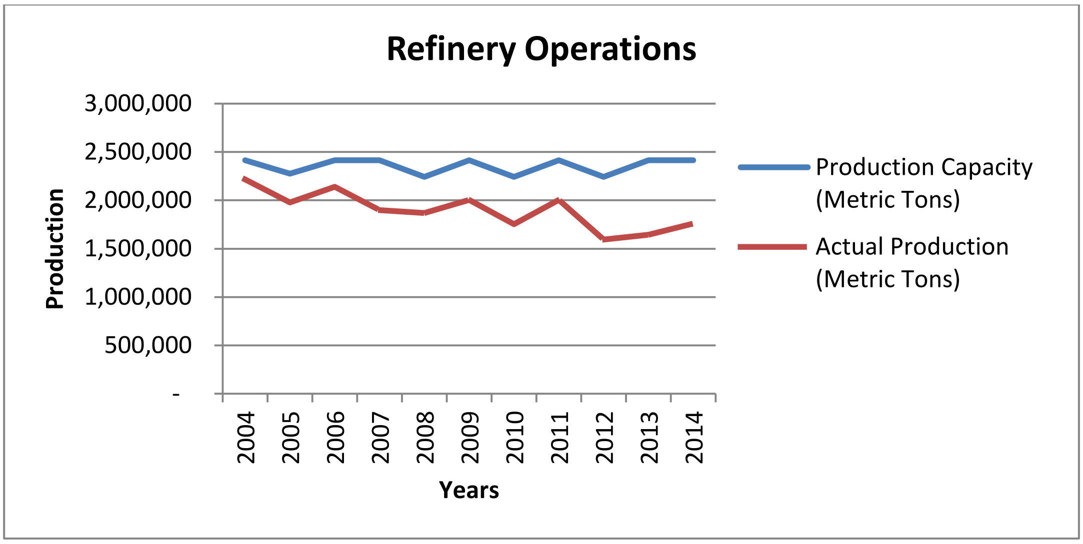
Without Refinery modifications, cost of locally refined fuel oil cannot be reduced."

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 1,760,170 metric tons in 2014 as compared with 1,643,218 metric tons in 2013, 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 2014 too. The Crude Oil intake for the year 2014 and previous ten years as compared with the production capacity for the respective years are shown in the following table and chart.

Year	Quantity of Crude Oil Intake (processed) for the Production		Capacity Under Utilized	
	Available Capacity (MT)	Actual Utilization (MT)	Quantity (MT)	Percentage
2014	2,415,000	1,760,170	654,830	27.12
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



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 the petroleum products are supplied to the market in a cost effective manner. Moreover the expenditure incurred by the Corporation amounting to Rs. 837.6 million for this project up to 31 December 2014 was observed as an uneconomic transaction.

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

"We are processing different crude mixes (Murban + Oman Blend) in different periods which will lead to changes of the maximum capacity of processing.

Refinery had to be closed down on one occasion during the year 2014 for a total period of one month due to shortage of crude supply with the SPBM hose failure. Furthermore, there were two regenerations for nearly another one month with low throughput operation during this year.

However, Refinery needs to be modified at the earliest to avoid some failures of old equipment and to avoid frequent regenerations while enhancing the profitability and operational flexibility."

4.4 Matters in Contentious Nature

The following observations are made.

(a) Incurring a sum of Rs. 6,146,110 in December 2014 for the purchasing of food items to distribute among the people in Pannala area just before the Presidential Election with the approval of the Chairman as recommended by the Managing Director could not be considered as authorized and regular payment. Further, the relevancy of such payment to the Corporation was also not ensured in audit.

(b) Ceylon Electricity Board (CEB) had not complied with the conditions that agreed to settle all the outstanding balance within 14 days with effect from 30 September 2013, and accordingly, the Corporation had charged a nominal interest rate at three month Treasury Bills rate plus 0.5 per cent for the overdue invoiced value with effect from 20 April 2013. But, the CEB had not recognized that amount as payable.

(c) Even though the Corporation sells fuel to the CEB for power generation since several years, a formal agreement or MOU between those two parties in order to ensure the smooth operation of the individual institutions had not been entered.

(d) The General Treasury had agreed to settle the kerosene subsidy receivable from the Government by setting off the custom duty payable to the Government by the Corporation for the year under review. Accordingly, a sum of Rs. 3,022,774,886 had been settled as a part payment of kerosene subsidy receivable for the period of 2008 – 2013 against the custom duty payable by Corporation for the year 2014. However, the balance of kerosene subsidy due from the General Treasury for the period 2008 to 2013 had not been recognized as receivable in the financial statements. Further, recognizing the kerosene subsidy of Rs. 2,715 million of as an income of the year 2014 without having substantial evidence for receiving is not prudent.

(e) The Corporation had paid the Pay As You Earn (PAYE) Tax amounting to Rs. 104 million for the year 2014 out of its own funds on behalf of its employees in contrary to the instructions of the Section 3.2 of the Public Enterprises Circular No. PED/12 of 2 June 2003 on Public Enterprises Guidelines for Good Governance, and the Public Enterprises Circular No. 02/2013 dated 11 September 2013.

4.5 Assets Management

The following assets had been lying idle since the acquisition.

(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. However, this land is occupied by more than 700 squatters.

(b) Mobile LPG Filling Plant - An LP Gas filling equipment having a filling capacity of 60 tons of LP Gas to 13.5kg LPG Cylinders in 10 hours was purchased by the Corporation in the year 2009 at a cost of Rs. 24 million for commissioning of retail business of LPG. Nevertheless, the Corporation had not initiated commercial operations up to 31 August 2015, and that asset had remained idle since then.

(c) Mahena Land – Even though, according to the correspondence made available the Corporation had paid a sum of Rs. 0.625 million for acquisition of Mahena land, it land had not been accounted for, and is being utilized by the previous owner since the acquisition in 1986.

(d) Investments - The caring value of the investment made in quoted and unquoted shares of four companies as at 31 December 2014 was Rs. 38.63 million. However, no dividend since longer period had 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 51 employees (including three employees in senior staff level and eighteen employees in secondary staff level) and seven vehicles to outside parties and incurred over a sum aggregating Rs. 50 million as remuneration and maintenance expenses during the year 2014.

4.7 Human Resources Management

The following observations are made in this connection.

(a) Out of the total approved cadre of 3,284 of the Corporation for the year under review, 622 posts or 19 per cent were in vacant as at 31 December 2014 and out of that, 23 per cent was in the senior staff level. Accordingly, running the entity's operations efficiently having such a huge number of vacancies was questionable to audit.

(b) Seven posts in all categories had been filled on contract basis, and the Chief Internal Auditor had been acting in the post of Deputy General Manager (Finance) since the mid of 2011 due to the former Deputy General Manager (Finance) has been on compulsory leave since 11 February 2009 subject to the decision of a disciplinary inquiry which had been held regarding the Hedging transactions.

(c) Adequate actions had not been taken to fill the vacancies as at 31 December 2014.

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