

State Timber Corporation - 2014

The audit of financial statements of the State Timber Corporation for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under any 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, 29 of the State Industrial Corporations Act, No.49 of 1957. 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.

1.2 Managements 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 Accounting Standards consisted 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 judgment, including the assessment of risks of material misstatements 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 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 financial statements. Sub-sections (3) and (4) of the 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

In my opinion except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Timber 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.

2.2. Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

The following non-compliances with Sri Lanka Accounting Standards were observed.

(a) Sri Lanka Accounting standard-16

- (i) When accounting of property, plant and equipment, they should depreciate over their useful life and account. However, 7020 items costing Rs. 884,268,443 of which written down value of the each item was Rs. 5 and 04 items costing Rs. 5,827,394 of which net carrying amount was zero were included in the property, plant and equipment costing Rs. 905,640,314 as at 31 December of the year under review. Actions had not been taken to either dispose these assets, if they cannot utilize or to revalue the assets in order to account their fair values, if they can further utilize.
- (ii) The useful life of the fixed assets estimated by the Corporation was incorrect and therefore, annual depreciation was also inaccurate.
- (iii) An aggregate value of Rs. 48,648 relating to 33 items that were not exceeding Rs. 4,000 was included in the land value of Rs. 76,729,723 as at 31 December of the year under review. Revaluation of lands had not been done according to the Standard and action had not been taken to show the fair value of the lands in the financial statements.

(b) Sri Lanka Accounting standard-37

Even though a sum of Rs. 1,957,174 had to be paid as the salary arrears to an officer who had been interdicted and subsequently discharged from the allegations, an allocation had not either been made or disclosed in the financial statements. The Chairman of the Corporation had informed me on 13 July 2015 that payment of salary arrears to the interdicted officer had been rejected by the Board of Directors and it had been informed to the Commissioner General of Labour.

(c) Sri Lanka Accounting Standard-40

A rent income amounting to Rs. 15,042,601 had been earned by the Corporation by renting out part of the Head Office building of the Corporation. However, the value

of the building had not been shown in the financial statements as an investment property.

2.2.2 Accounting Deficiencies

Even though the expenditure should be classified as much as possible in order to make a fair presentation, an aggregate amount of Rs. 3,443,573 had been shown as miscellaneous expenses in the financial statements.

2.2.3 Unexplained Differences

According to the financial statements of the Corporation as at 31 December of the year under review, payable stumpage amounted to Rs. 964,283,581 but as per the accounts of the Forest Conservation Department, corresponding receivable stumpage amounted to Rs.1,056,375,539. Thus a difference of Rs. 92,091,958 was observed between the Corporation's accounts and the Department's accounts.

2.2.4 Lack of Evidence for Audit

The trial balances prepared relating to the Regional Offices of Kandy, Monaragala and Furniture Unit in Ampara had not been furnished to audit.

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) As compared with the preceding year, balance of the trade debtors for the year under review had increased from Rs. 475 million to Rs. 760 million representing 62 per cent. Out of debtor balance receivable for the year under review, Rs. 43 million for over one year, Rs. 21 million ranging from 2 to 3 years and Rs.12 million for over 4 years had remained outstanding.
- (b) Loan balances amounting to Rs.568,500 receivable from a Government Department since the year 2008 and Rs.11,873,954 receivable from a private company since the year 1983 were expected to write off as bad debts.
- (c) Receivable sundry debtor balances amounting to Rs. 3,828,645 belong to 04 Regional Offices remained as further outstanding.
- (d) A sum of Rs. 3,692,862 had been remained as recoverable for a period ranging from 01 to 05 years due to the non- recovering of advances from the final payments made to timber and timber products suppliers or due to unsupplied of goods.
- (e) Receivables under the general deposit balance relating to 4 Regional Offices amounting to Rs. 3,330,933 remained as further receivables.
- (f) Cheques valued at Rs.110,552 received by the Corporation during the year under review had been dishonoured and that amount remained as further receivables.

- (g) A sum of Rs. 1,860,952 which had been incurred by the Timber Corporation for the Ministry of Environment and Natural Resources had not been recovered so far.
- (h) An age analysis had not been furnished relating to the sundry creditors amounting to Rs.128,298,983 as at 31 December of the year under review. Hence, outstanding period of creditors had not been revealed.
- (i) Stumpage amounting to Rs. 52,155,675 which had been shown under the sundry creditors relating to the Anurdhapura Regional Office had not been settled so far.
- (j) Action had not been taken to calculate the non- liable deposits and credit to the income, out of the refundable bid deposits, security deposits and forest offence deposits aggregating to Rs. 19,278,900.
- (k) Action had not been taken to settle the gang nail deposit of Rs.2,855,000 remained for a period of more than two years.

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

Instances of non-compliance with laws, rules, regulations and management decisions are given below.

Reference to Laws, Rules, Regulations, etc.

Non- compliance

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| (a) Employees' Trust Fund Act, No. 46 of 1980. | According to the Act, the contribution should be remitted before end of the following month of which salaries/wages had been paid. However, due to non- remittance of the contribution within the due period, a sum of Rs. 95,714 had been paid as penalties. |
| (b) Establishments Code of the Democratic Socialist Republic of Sri Lanka.
(i) Volume – I of the Establishments Code | Even though provisions had not been provided through the Establishment Code for allocation of vehicles for the union activities, a vehicle has been given to a union since the year 2013. A sum of Rs. 87,120 had been incurred for fuel of that vehicle during the year under review. |
| (ii) Volume – I , Section 4 of Chapter XXV of the Establishments Code | As number of members in the union exceeded 1,600, a permanent officer could have been released for the union activities. However, without doing so, the chairman of the union had used this vehicle for union activities for 275 days of the year under review. |

- (c) Management Services Circular No. 39 dated 26 May 2009 of No. DMS/A/8/27 A sum of Rs. 448,110 had been paid for 14 officers of Timber Corporation without having the provisions in scheme of recruitment and by approving salary increments contrary to the circular instructions and a sum of Rs. 382,200 had been paid as salary increments for another two officers from January 2013 to June 2014. The Department of Management Services had informed to recover this amount and as well as a decision had been made to recover this amount at the Audit and Management Committee meeting held on 26 March 2015. However, it had not so done according to that decision.
- (d) Procurement guidelines of 2006
- (i) Section 2.8.4 In purchasing technical equipment with high values an outside person who has the expertise knowledge should be appointed to the Technical Evaluation Committee by the line Ministry or procurement entity. Nevertheless, the Corporation had not appointed such a person to the committee.
- (ii) Section 4.2.3 According to Section, after receiving the Technical Evaluation Committee approval, the goods should be purchased within 4 weeks. Nevertheless, procurement of spare parts to PAZZALATO sawing machine had been made after holding off 05 months and 24 days since the receiving of the technical evaluation committee report.

3. Financial Review

3.1 Financial Results

The operations of the Corporation had resulted in a pre-tax net profit of Rs.402,222,441 for the year under review as compared with the pre-tax net profit of Rs.332,336,761 for the preceding year, thus showing an increase of Rs.69,885,680 in the financial result for the year under review. The decrease of the levy paid to the Treasury in the year under review by Rs.25 million had been the main reason for this improvement.

3.2 Analytical Financial Review

- (a) An operating profit of Rs. 1,453,450,911 had been earned by the Corporation from its main operations and this was an improvement of Rs. 255,835,713 as compared with the operational profit of Rs. 1,197,615,198 for the preceding year.

- (b) Non- operating income amounting to Rs. 222,826,051 had been included in the pre-tax profit of Rs. 427,222,441 for the year under review and this was significantly represented 52 per cent out of the pre-tax profit. As compared with the preceding year there was 11.74 per cent improvement in the net profit for the year under review.

3.3 Legal cases instituted against or/by the Corporation

The following observations are made.

- (a) Twenty legal cases comprising of 04 labour tribunal cases, 02 magistrate court cases, 07 district court cases, 02 high court cases, 03 appeal court cases and 02 Supreme Court cases had been instituted against the Corporation by the outside parties by end of the year under review.
- (b) A case instituted before magistrate court by the Corporation was being heard by the end of the year under review.

4. Operating Review

4.1 Performance

The following observations are made.

(a) Sale of Sawn Timber

According to the Action Plan for the year under review, it was planned to generate a total income of Rs.337 million from sale of sawn timber. However, the actual sales income amounted only to Rs.156 million, representing 46 per cent. Failure of the Corporation to compete with the competitive sawn timber prices in the market and failure to implement market strategies after conducting market studies in order to increase the sales had affected this situation.

(b) Performance of the Furniture Division

- (i) Only a profit of Rs. 648,141 had been generated from the sale of furniture which had been manufactured through the Finger Joint machine installed at the Boossa sawing mill incurring a sum of Rs. 6,190,950 in May 2013. It was observed in audit that it had failed to earn a considerable profit from the installation date of the machine up to December of the year under review.
- (ii) A loss of Rs. 17,626,742 was incurred by the Kaldemulla Furniture Manufacturing Complex during the year under review. Failure to minimize the cost of production was the main reason for this loss.

(c) Performance of the Manufacturing Activities

Position of the timber and timber related products manufactured by the Corporation during past several years are shown below.

- (i) A decrease of 42 per cent in sawn timber production from the year 2010 to end of the year under review was observed.
- (ii) The decrease in manufacturing of sleepers and electricity transmission poles from the year 2009 to end of the year under review were 62.73 per cent and 76 per cent respectively. A continuous deterioration in the manufacturing was observed after the year 2010 to the year of the under review.
- (iii) The furniture manufacturing division had incurred continuous losses. The high production costs that caused to fixed high prices for the finished goods were the main reasons for those losses.

4.2 Deficiencies in Contract Administration

The following observations are made

- (a) The contractors, entered into agreements with the Corporation for falling of timber at sites, are bound to devolve sureties on 10 per cent of the contract value once entered in to contract agreements, until completion of works at the sites. However, when contractors had performed several contracts simultaneously same surety had given for several contacts before completing the related contract.
- (b) The contract for supply of timber at the Site of Kakuulpathweva in Pollonaruwa had been awarded under a short work agreement from 05 July 2013 and action had not been taken to recover penalties for failure of completion of works on due dates.
- (c) Evidence relating to the calling of tenders publishing tender notice in the newspapers for the contract of modification of Regional Office of Puttalam had not been furnished to audit. However, particulars relating to submission of bids by 06 institutions had not been furnished to audit. Out of the bids, third minimum bidder had been selected on the recommendation made by the Technical Evaluation Committee. Action had not been taken to recover penalties amounting to Rs.138,713 for delay to complete the contract works by 153 days. According to the primary estimate of the contract, it had agreed to supply of 623 soil cubic meters. Nevertheless, a sum of Rs. 645,000 had been paid for supplying of 300 soil cubic meters. However, an estimate amounting to Rs. 4,593,800 had subsequently been submitted for supply of 1,300 soil cubic meters exceeding the primary estimate and a sum of Rs.546,345 had been paid for supplying of additional 513 soil cubic meters without having the approval.

4.3 Identified Losses

The following observations are made

- (a) When making payments to the contractors, an over payment amounting to Rs. 597,718 had been made to the contractors as the payment of Value Added Tax on the retention money.

- (b) A Laptop Computer, computer accessories, Samsung Mobile Phone Tab and binocular which had been given by the Corporation for the use of the Ex- Chairman had not been returned to the Corporation.

4.4 Human Resource Management

At the examination of pre-work programmes submitted by the officers of the Corporation, it was revealed that controlling over the submission of pre programmes, approving and engagement on duties according to the programmes were in weak level.

5. Accountability and Good Governance

5.1 Corporate Plan

Even though a Corporate Plan for the period 2013-2017 had been prepared by the Corporation, actions had not been taken to update the Plan in terms of Section 5.1.1 of the Public Enterprise Circular No. PED 12 of 02 June 2003 by reviewing it periodically.

5.2 Action Plan

The following observations are made.

- (a) Capital expenditure for the year under review had been basically categorized under 17 Programmes. However, any capital expenditure programme had not been mentioned in the Action Plan prepared for the year under review and the Projects amounting to Rs.286,440,500 that had been mentioned in the budgeted estimate prepared for the year under review had not been complied with the Projects amounting to Rs. 423,000,000 mentioned in the Corporate Plan. Accordingly, it was observed that Action Plan and annual estimates had not been prepared based on the Corporate Plan.
- (b) It was observed that an Action Plan had not been prepared covering all sections of the Corporation such as human resources, information and technology, research, development and training.

5.3 Procurement Plan

A difference of Rs. 59,480,500 was observed between the procurement plan prepared relating to the logs sales (contract) and budgeted logs sales (contract).

5.4 Audit and Management Committee Meetings

Audit queries and audit reports submitted by the External Auditors should be discussed at the Audit and Management Committee Meetings as clearly emphasized by the circular instructions i.e. Public Finance Circular dated 19 November 1999, the Ministry of Finance and Planning Circulars No. BD/PE02/2000 of 30 March 2000 and Public Enterprise Circular No. PED/55 of 14 December 2010. However, discussion of External audit reports/ Audit queries had not been included in the agenda of the Audit and Management Committee Meetings held after 30 September 2014.

5.5 Budgetary Control

The following observations are made

- (a) The Budget for the year under review had not been prepared according to the Corporate Plan and the Action Plan.
- (b) Significant variances were observed between the budget and the actual income and expenditure thus indicating that the budget had not been made use of as an effective instrument of management control.

5.6 Unresolved Audit Paragraphs

Even though the Chairman of the Corporation had informed on 28 June 2013 that further action would be taken after the receipt of the Report of the Joint Committee appointed to recommend the action to be taken against the contractor and the Corporation officers in respect of unauthorized felling in the Bagawanthalawa Chapelton commercial level plot of land, no action whatsoever had been taken in that connection even by 20 May 2015.

6. Systems and Controls

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

- (a) Accounting
- (b) Debtors Control
- (c) Creditors Control
- (d) Budget
- (e) Assets Management
- (f) Contract Administration
- (g) Staff Administration
- (h) Procurement