

Kurunegala Plantations Limited - 2015

The audit of financial statements of the Kurunegala Plantations Limited comprising the statement of financial position as at 31 December 2015 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 my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka. My comments and observations which I consider should be published with the Annual Report of the Company appear in this report.

1.2 Establishment and Ownership of the Company

The Kurunegala Plantations Limited (KPL) is a limited liability company incorporated under the Companies Act, No. 17 of 1982 in terms of conversion of the Corporations and Government Owned Business undertakings into public companies under the Act, No. 23 of 1987 and re-registered under the Companies Act, No. 07 of 2007. This is a fully government owned Company and the Secretary to the Treasury is being the single shareholder of the Company.

1.3 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") 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 Board determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 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 Auditing 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 judgement, including the assessment of the risks 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 Company'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 Company'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.

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

1.5 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 Kurunegala Plantations Limited as at 31 December 2015 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 Accounting Deficiencies

The following accounting deficiencies were observed in audit

- (a) A contract was awarded to a private company in order to remove the consumable biological assets valued at Rs. 4,590,300 during the year under review. Although this work was not performed during the year 2015, the value of the consumable biological assets had been written off from the accounts in the year under review. Therefore, the consumable biological assets and the profit for the year under review had been understated by that amount.
- (b) The land with extent of 455.6 hectares released during the period from 2004 to 2015 on government requirements had not been valued and adjusted in the accounts even as at 31 December 2015.
- (c) The land with extent of 40.98 hectares with the immature planting costing Rs.7,108,457 in Gatakulalanda Division of the Hiriyala Area Estate had been granted for resettling purpose during the year 2014. However, no adjustments had been made in the accounts in that year instead, it was adjusted in the accounts of the year 2015.

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

Instances of non-compliances observed in audit are given below.

Reference to Laws, Rules, Regulations, etc.	Non-compliance
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(a) Paragraph 6.2 (a) of the Payment of Gratuity Act, No 12 of 1983	The Board of directors had decided to pay one month salary for their retiring employees with more than 10 year service period in respect of each completed year instead of being paid half a month salary. As a result a sum of Rs.10,141,160 had been overpaid to retired employees.

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|--|--|
| <p>(b) Guideline 6.2.2 of Government Procurement Guidelines</p> | <p>Although the period allowed for the preparation and submission of national competitive bids was 21 days, the Company had granted only 14 days for calling bids in respect of construction of quarters for its staff.</p> |
| <p>(c) Fresh Coconut Auction Rules of the Coconut Development Authority

Rule No. 21</p> <p>Rule No. 26</p> | <p>The Buyer who purchases the coconut parcels should be settled the dues within 35 calendar days. However, actions had not been taken to recover the outstanding balance of Rs. 2,442,827 from the buyers even after 05 months since the date of sales.</p> <p>Although the Company should take necessary actions after informing the Coconut Development Authority against the buyer who failed to settle the initial payment of 25 per cent on the sales value, actions had not been taken accordingly.</p> |
| <p>(d) Letter No. DMS/E3/39/8/222 of 26 October 2009 issued by the Director General of Department of Management Services</p> | <p>All-inclusive a monthly allowance of Rs. 72,300 had been approved to the Chief Executive Officer (CEO) of the Company. However, the CEO of the Company had been paid Rs. 80,000 as initial monthly salary and thereafter, it was increased up to Rs. 297,500 in time to time by the Board of Directors without being obtained the approval from the Department of Management Services.</p> |

3. Financial Review

3.1 Financial Result

According to the financial statements presented, the operations of the Company for the year ended 31 December 2015 had resulted in a pre-tax profit of Rs. 165,922,947 as compared with the corresponding pre-tax profit of Rs. 220,906,476 in the preceding year, thus indicating a deterioration of Rs. 54,983,529 in the financial results for the year under review. The decrease of revenue from sales of coconut, rubber and pepper as compared with the preceding year was the main reason attributed for this deterioration in the financial result.

3.2 Analytical Financial Review

3.2.1 Profitability of Major Product Items

The contributions received from major product items as compared with the previous two years are given below.

Contribution {favourable/(adverse)}

<u>Product</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>
Coconut	170,843,902	177,493,786	129,805,642
Rubber	(6,945,469)	(2,356,345)	13,988,267
Rambutan	2,923,727	3,053,870	2,403,732
Pepper	831,513	2,761,778	1,112,053
Cashew	552,158	2,483,600	57,527
Mango	1,629,773	978,540	-

The following observations are made in this regard.

- (a) The contribution received from rubber production had been drastically decreased by Rs.20,933,736 or 150 per cent in the year under review as compared with the year 2013. It was further observed that, the rubber production in the year under review was decreased by 16,796 kilograms or 11 per cent as compared with the preceding year.
- (b) The contribution received from pepper production had also been decreased by Rs.1,930,265 or 70 per cent in the year under review as compared with the previous year and the pepper production had been decreased by 1,885 kilograms or 60 per cent in the year under review as compared with the preceding year. Hence, the revenue from pepper production too decreased by 50 per cent in the year under review.

3.2.2 Significant Accounting Ratios

According to the information made available, some important ratios of the Company for the year under review and the preceding year are as follows.

	<u>2015</u>	<u>2014</u>
Gross Profit Ratio	35%	43%
Current Ratio	6.91 : 1	6.52 : 1
Quick Asset Ratio	6.48 : 1	5.99 : 1

The following observation is made in this connection

It was revealed that the Company had continuously maintained excess working capital without being invested them in long term investment sources and as such the working capital management of the Company was at very weak level.

4. Operating Review

4.1 Performance

4.1.1 Achievement of Targets

According to the progress report, action plan and other information made available for audit some key targets and their achievements during the year under review are shown below.

Item	Targets	Achievement	Achievement as a percentage of Targets
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			%
Coconut Crop (nuts in million)	18.07	14.07	77.8
Average yield per palm	72	29.46	40
Average nuts per Acre in S4 Land Type	2,835	1,786	63

4.1.2 Performance of Planting Area Estates

The production, sales income and profit /(loss) of 08 Planting Area Estates belonging to the Company as compared with previous two years are given below.

Estate	<u>Production</u>			<u>Sales Income</u>			<u>Profit /(Loss)</u>		
	2015	2014	2013	2015	2014	2013	2015	2014	2013
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	Nuts.Million	Nuts.Million	Nuts.Million	Rs.Million	Rs.Million	Rs.Million	Rs.Million	Rs.Million	Rs.Million
Attanagalla	1.7	1.7	1.8	59.4	56.7	62.1	30.1	31.2	39.9
Dambadeniya	1.3	1.5	1.3	41.1	45.5	42.0	13.1	17.3	16.3
Dodangaslanda	2.0	2.5	1.5	68.4	78.4	44.3	32.2	45.9	18.0
Hiriyala	2.6	2.9	1.5	69.7	82.6	36.1	27.0	33.4	3.7
Katugampola	1.6	2.1	2.1	55.1	70.4	69.5	17.8	29.3	37.4
Kurunegala	2.0	2.8	1.9	57.3	78.7	54.3	21.0	39.3	24.7
Mahayaya	1.1	1.1	1.1	38.6	37.1	38.8	17.8	17.5	20.8
Narammala	1.7	2.1	1.7	52.4	64.5	55.1	20.7	32.9	28.4

The following observations are made.

- (i) Even though the Company had recorded the highest coconut crop in the year 2014, Atthanagalla Area Estate had failed to achieve its maximum crop in that year as compared with the year 2013.
- (ii) The highest Cost of Production (COP) as compared with last two years had been recorded in the year under review and thereby the contribution from the products had been dropped by Rs. 2 in the year under review.
- (iii) Although the Hiriyala Area Estate is consisting 20 per cent of the Company's total coconut extent of 4085 hectares, only 12 per cent or Rs. 53,997,824 had been contributed to the coconut income for the year under review.

4.2 Operating Inefficiencies

4.2.1 Pepper Cultivation Project

The following observations are made.

- (a) Even though the cost relating to pepper cultivation project had increased from Rs.427,462 in the year 2014 to Rs. 630,147 by the year 2015 or by 47 per cent, the revenue from pepper cultivation had decreased from Rs. 3,189,240 in the year 2014 to Rs. 1,461,660 or by 54 per cent as at end of the year under review.
- (b) According to the technical hand book of the Department of Export Agriculture, the average crop per pepper plant should be 1.5 to 2 kilograms per annum. However, the Company had obtained only 1270 kilograms pepper harvest from its 23,178 plants or 4 per cent that indicated a poor yield from the pepper cultivation. It was further observed that the harvestable plants were only 41 per cent of the total number plants due to lack of agricultural practices.
- (c) The pepper crop of 1.5 kilogram had been collected from Atthanagalla Area Estate by spending Rs. 55,312 in the year under review and it was revealed that this pepper field had exceeded its useful economic life.

4.2.2 Paddy Cultivation

It was revealed that the Company had utilized only 36.42 hectares of paddy land out of its total paddy harvestable land of 86.13 hectares. Therefore, the Company had failed to utilize 57 per cent of the paddy land belonging to Hiriyala Area Estate. As a result the overall net income per hectare for a season was only Rs.10,378

4.2.3 Coconut Cultivation

The Company had not taken necessary measures to improve the coconut cultivation in the following planting estates.

(a) Hiriyala Area Estate

Even though the average palms per hectare should be 150, it was only 107 in the Hiriyala Area Estate. It was further observed that the crop in the year under review had been decreased by 427,887 nuts as compared with the previous year.

(b) Atthanagalla Area Estate

- (i) Even though it was supposed to maintain 64 coconut palms per hectare, there were only 25 and 29 palms per hectare in Danavkanda and Thippalathenna Divisions respectively.

- (ii) The standard coconut crop per palm in the industry was 72 nuts whereas the Atthanagalla Area Estate had harvested only 21 to 54 nuts in the year under review.
- (iii) Censes on coconut palms had not been completed in this Estate even as at the date of audit on 10 March 2016.
- (iv) Out of 392 palms, 163 non-bearing palms were observed in the audit test check carried out in field No 04 of Wayagolla Division and it was further observed that actions had not been taken to replant 60 abortive palms even as at the date of audit on 10 March 2016.

4.2.4 Rubber Cultivation

The followings matters were observed.

- (a) There were only 37,515 rubber trees in 110.9 hectares belonging to Atthanagalla Area Estate even though there should be 500 trees per hectare as per the standard. However, the Company had not taken effective actions to increase the number of trees in the Estate.
- (b) Sales of latex in Atthanagalla and Dodamgaslanda Area Estates had been performed by the private parties based on the prices determined in the year 2011 and no quotations were called thereafter up to the end of 2015. Sales of latex in Mahayaya Area Estate had not been quoted even in the year 2011 and given to a private party without an agreement.
- (c) It was recorded the average latex of 3 to 6 kilograms per day in Atthanagalla Division and the annual latex collection was reported as 664 kilograms per hectare which was a far behind with compared to the standard indicator of the Department of Rubber Research. It was further observed that the negative contribution per kilogram of rubber for the year 2015 was around Rs. 43.
- (d) According to the statistics of the Department of Rubber Development, the Company had recorded an overall low rubber progress of 544 kilograms per hectare with compared to the average rubber production of 748 kilograms per hectare reported in Sri Lanka.

4.2.5 Collecting the Fallen Coconuts

The following observations are made.

- (b) Information relating to fallen nuts in Danavkanda Division at Atthanagalla Area Estate during the period from 01 January to 07 February 2015 had not been certified by any officer. However, the unusual amounts of 240 nuts were recorded at the office during this period even it was an average of 20 nuts per day.
- (c) The Company had failed to take necessary action against the watcher attached to Atthanagalla Area Estate, even though it had proven that this watcher had regularly reported incorrect information about the fallen nuts.

4.2.6 Coconut Picking

The following observations are made.

- (a) According to the policy of the Company, the coconut picking is performing once in every 30 days resulted 12 pickings per year. However, it was observed that the picking was conducted before 30 days after 30 days as well. Therefore, the Company had failed to maintain a proper time period for this task.
- (b) The process of coconut picking had been outsourced by the Company. However, the outsourcing process had been carried out without any Board decision and also there is no any written agreement between the parties.

4.2.7 Mite Affected Coconut Palms

According to the instruction given by the Mite Lab it should be continued the treatments in 3 times with the time gap of 90 days to cure Mite affected palms. Nevertheless, a delay of 153 days to 240 days was observed in audit and the Hiriyala Area Estate has not performed the third treatment even as at the date audit on 04 March 2016. As such the Mite affected nuts had been gradually increased from 11 per cent at the beginning of the year 2015 to 64 per cent by the end of the year 2015 and the overall Mite affected nuts in Kurakkane Division was 48 per cent. Further, several Mite affected palms and nuts were found during the test audit check carried out in the year under review.

4.2.8 Coconut Auctions

The followings matters were observed during the course of audit.

- (a) When the coconut parcel sending to auction in second attempt, those had to be sent under re-sale category. However, such coconut parcels (LOT) had been offered to auction in three or four times without being categorized as re-sales.
- (b) During the year under review, in 85 occasions the coconut sales had been conducted through auctions and in 78 occasions it had been conducted through local sales. Though the local sales had recorded relatively higher prices than the auction, the Company had not taken necessary measures to identify the reasons for poor performance of the auction sales and communicate those with the Coconut Development Authority.

4.2.9 Providing Lands on Lease Basis

The Board of Directors had decided to provide the land with extent of 102 acres and 02 rude belonging to four Planting Area Estates to 19 outside parties on lease basis in order to planting the subsidiary crops. However, the policy for selecting the lands and persons had not been explained to audit.

4.2.10 Valuation of Consumable Biological Assets

At the audit test check it was revealed that, a cubic decimeter of timber had been valued at Rs.80.34 for the purpose of valuing the biological asset (timber) as at the end of the year under review. However, a cubic decimeter of same timber had been revalued as Rs. 75.90 for the disposal purpose. Hence, it was observed that, two different values had been applied to valuing the same consumable biological assets of the Company without any valid reason.

4.2.11 Operation of Rubber Factory

The following observations were made

- (a) The operations of the rubber factory at Atthanagalla Area Estate constructed by spending Rs. 12,078,708 exceeding the estimated cost of Rs. 6 million had been commenced its operations in November 2013 and subsequently suspended in March 2014 due to non-obtaining the environmental protection licenses. Therefor the estimated net income of Rs.10,863,465 had not been generated.
- (b) It was further observed that no feasibility study had been carried out before constructing this factory and a sum of Rs. 5,552,352 had been incurred to construct an effluent plant increasing the total cost to Rs.17.5 million resulted a deviation of 191 per cent of the estimated cost.

4.2.12 Implementation of Foliage Project

The Company had incurred an overall loss of Rs. 14,932,214 including an operational loss of Rs. 3,693,432 from Foliage Project implemented in Atthanagalla Area Estate during the year under review.

4.3 Identified Losses

The following losses were observed during the course of audit.

- (a) A sum of Rs. 515,096 was lost to the Company due to providing the low prices by the buyer instead of being provided the high prices to determine the buying price of 1 kg RSS 1 rubber which prevailed at the market during the year under review.
- (b) A loss of Rs. 714,020 incurred due to the damage course to the mango cultivation by flood during the previous year had been written off during the year under review.

4.4 Items of Contentious Nature

- (a) It was observed in audit that the Company had not remitted or accounted the Value Added Tax of Rs. 905,112 on copra manufacture carried out during the year under review.

- (b) It was advised to conduct nut burning process under the supervision of a staff officer. Nevertheless, it was revealed in audit that this task had been performed by a watcher himself at his virtue in Madurankanchiya and Kurakkane Divisions.
- (c) A sum of Rs.3,075,000 had been paid to a private institution in the year 2014 as donations without obtaining an approval from the Cabinet of Ministers as per paragraph 8.3.8 of the Public Enterprises Circular No. PED 12 of 02 June 2003. Further, the Presidential Commission of Inquiry is in progress in this regard.
- (d) Ten Coconut Lots belonging to Atthanagalla and Dambadeniya Area Estates offered for auction had been subsequently withdrawn from the auction and thereafter those coconuts were sold locally by the Company. However, a sum of Rs. 69,501 had been paid to the Broker since it was treated as auction sales.
- (e) It was observed that 7 annual salary increments had been granted to employees of the Company within two years based on one year performance and in addition to that the bonus and incentives allowances had also been paid during this period.
- (f) The CEO of the Company had been granted 3 in-house labour salaries of Rs.533,484 in addition to the monthly allowances entitled to him.

4.5 Idle and Underutilized Assets

A rubber factory in Dammullahena valued at Rs. 12,078,708 and shown under the non-current assets of the Company had not been in functioned since 2014.

4.6 Human Resources Management

The following observations are made.

- (a) Reducing the scope by amalgamating Dathusenapura and Wariyapola Divisions in Hiriyala Area Estate had been caused to 22 excess cadre and no steps had been taken in this regard.
- (b) Even though six posts of Officers in-Charge which may directly affect the efficiency of the Company's operations had been vacant for more than 12 months, the Company had not taken any meaningful steps to fill these vacancies. In the meantime, an OIC had been employed in Atthanagalla Division which did not have approved cadre.
- (c) Additional 16 labourers had been employed as Cash Workers in Atthanagalla and Hiriyala Area Estates without obtaining the required approvals from the relevant authorities.

5. Accountability and Good Governance

5.1 Annual Action Plan

Although an Action plan had been prepared in line with the Corporate Plan, the Company had failed to identify the responsibilities of managers with goals and targets expected to achieve during the year under review.

6. Systems and Controls

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

Areas of Control -----	Observation -----
(a) Staff Administration	- The cash workers were not presented in morning parade and attendance could not be checked in audit since there were no records. Further, sufficient internal controls had not been implemented in this regard.
(b) Payroll System	- The signature of some labourers recorded in the attendance register differ from one another - Work done by the Cash Workers had not been entered in the Muster Sheets.