Lanka Coal Company (Private) Limited - 2015

The audit of the financial statements of the Lanka Coal Company (Private) Limited ("the Company") for the year ended 31 December 2015 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.

1.2 Management'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.

1.3 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. 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 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 Board, 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.

1.4 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 Lanka Coal

Company (Pvt) Ltd 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 the Financial Statements

2.2.1 Compliance with Sri Lanka Accounting Standards (LKAS/SLFRS)

The following observations are made.

(a) **LKAS 19- Employee Benefits:** The Company had not invested its retirement benefits in order to meet the future obligation and the steps to be followed for accounting the defined benefit plan in proper manner had not been implemented by the Company in terms of provisions in the Standard.

(b) **LKAS 39- Financial Instruments-Recognition & Measurement:**

(i) An entity has to be recognized its "loan and receivable" under the "financial assets" and subsequently measured at amortised cost using the effective interest rate method. However, the financial assets such as trade debtors advance for thermal coal shipment and trade debtors (CEB) steam coal etc. had not been measured at amortised cost.

(ii) The staff loans provided at below-market interest rate shall be subsequently recognized at amortized cost using the effective interest rate method and in addition to that the difference between the market interest rate and below-market interest rate which received from loans should be recognized as staff cost. However, the Company had not recognized staff cost as per the requirements of the Standard.

(c) **LKAS 36 - Impairment of Assets:** Every entity has to be carried out an impairment test on its receivables as at the end of each reporting period whether there is any indication that an asset may be impaired. Even though the Company have several disputes about its receivables from the Ceylon Electricity Board (CEB), the Company had not carried out an impairment test thereon as at 31 December 2015.

2.2.2 Accounting Deficiencies

An expenditure amounting to Rs. 264,950 incurred for the Bottom Ash Making Project had been reimbursed from the CEB as a part of the management fee. However, it was observed in audit that this expenditure could not be reimbursed from the CEB as this expenditure is not directly involved in the coal supplying process.

2.2.3 Un-reconciled Differences

The amount receivable from the CEB as at 31 December 2015 as per the financial statements of the Company was Rs.380,343,765. However, the corresponding amount shown in the financial statements of the CEB was Rs. 734,086,996. Hence, an un-reconciled difference of Rs.353,743,231 was observed between those two financial statements.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company during the year under review had resulted neither pre-tax net profit nor net loss as compared with the corresponding pre-tax net profit of Rs. 1,199,036 for the preceding year, thus showing a deterioration of Rs. 1,199,036 in the financial results of the year under review. Entering into a new agreement with the Ceylon Electricity Board (CEB) to reimburse the net overhead cost is the main reasons attributed for the above deterioration.

3.2 Analytical Financial Review

Financial Position

According to the information made available, the following table gives the highlights of the financial position as at the end of the year under review and the previous year.

Item	As at 31 December 2015	2014	Variance
	Rs.	Rs.	Percentage
Non-current Assets	2,086,083	1,198,955	74
Current Assets	1,070,269,331	926,877,382	15
Total Assets	1,072,355,414	928,076,337	15
Current Liabilities	1,000,361,221	857,013,405	16
Working Capital	69,908,110	69,863,977	0.06
Total Capital Employed	71,994,192	71,062,931	1.31
Non-current Liabilities	1,467,783	998,647	47
Equity	70,526,409	70,064,284	0.6

Accordingly, the total assets of the year under review as compared with the previous year had increased by 15 per cent.

4. **Operating Review**

4.1 Operating Inefficiencies

The main operating activity of the Company is to provide coal for the Lakvijaya Power Plant. In view of the delays occurred in Jetty and the crane break-downs at the vessel, 40 operating days had been lost to the Company during the year under review. As a result the demurrages paid during the period had been increased significantly.

4.2 Management Weaknesses

The following observations are made.

(a) The main source of income of the Company is management fee on handling of coal supply to the CEB. However, this income was not adequate to achieve its vision, mission and objectives, and to pay sufficient return (Dividends) to its shareholders. Further, as the management fee is equal to total overhead cost, less if any other income, it is demotivated to earn other income by performing any other business or activities as mentioned in the Article of Association.

(b) The basis of calculating of management fee when the other income is higher than the total overhead cost for any particular financial year had not been included in the agreement entered into between the Company and the CEB.

(c) Conditions in the bid documents pertaining to the penalty adjustments for coal quality had not been included in the coal supply agreement entered into between the Company and the Liberty Commodities Ltd (one of the coal suppliers). As a result, the Company had made an overpayment of Rs. 81,573,306 and Rs. 148,941,802 in the years 2015 and 2016 respectively.

(d) A sum of Rs. 1,047,220 had been spend for the annual trip of the Company and this expenditure had been included in the management fee in order to reimburse from the CEB. However, it was observed that the cost of annual trip is not a part and partial of the coal procurement business and cannot be reimbursed from the CEB under the management fee. Further, as a government owned Company this type of expenses could not be accepted in audit.

4.3 Human Resources Management

The following observations are made.

(a) A Scheme of Recruitment (SOR) had not been prepared and obtained the approval from the Department of Management Services.

(b) There were nine vacancies in the Company comprising 03 senior level posts, one secondary level post and 05 primary level posts as at the end of the year under review due to not maintaining realistic cadre and lack of periodic review of the cadre position. Further, the Company had created a new post within the cadre as “Transport

Assistant", without obtaining the approval from the Department of Management Services.

(c) Salaries of the employees had been fixed and paid in line with the salary scales of the CEB relating to each category of posts without obtaining proper approval.

5. Accountability and Good Governance

5.1 Corporate Plan

A Corporate Plan had not been prepared by the Company in terms of Public Enterprises Department Circular No. PED / 12 of 02 June 2003.

5.2 Audit Committee

Although the Company had formed its Audit Committee as per the Board decision taken on 19 June 2015, no Audit Committee meetings had been held during the year 2015.

5.3 Budgetary Control

The following observations are made.

(a) Significant variances ranging from 4 per cent to 162 per cent with respect to 38 items were observed between the budgeted and the actuals figures, thus indicating that the budget had not been made use of as an effective instrument of management control.

(b) According to the Public Enterprise circular No. PED / 12 of 02 June 2003, the Annual Budget should include a budgeted income and expenditure statement, a cash flow statement for the year and a balance sheet at the end of the year, and a budgeted capital expenditure statement together with an Annual Action Plan. However, the Company had not complied with this.

6. Systems and Controls

Special attention is needed in respect of the following areas of control.

	Areas of Control	Observation
(a)	Assets Management	Valuation, documentation and protection of property, plant and equipment and utilization of the resources of the Company efficiently for the purpose of performing its objectives.
(b)	Control over Debtors	Recovery of debtors and other receivables without delay and accounting them.

(c)	Human Resources Management	Management of human resources according to the role and the extent for the achievement of the objectives of the Company.
(d)	Financial Management	Effective financial management strategies should be used.
(e)	Internal Audit	An Internal Audit Unit should be established to strengthen the internal control of the Company.