Ceylon Petroleum Corporation – 2015

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 2015 comprising the statements of financial position as at 31 December 2015 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 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 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 2015 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 2015 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 Corporation had prepared the consolidated financial statements for the year 2015 based on draft financial statements of the Ceylon Petroleum Storage Terminal Ltd (CPSTL), the Subsidiary of the Corporation having two third interests, which had not been authorized by the Board for issue, and accordingly, it leads to serious doubtfulness about the credibility of the financial information.

(b) The auditors of the Ceylon Petroleum Storage Terminal Ltd (CPSTL) had expressed a qualified opinion on the financial statements for the year under review based on the following matters.

(i) The audited financial statements of the Ceylon Petroleum Corporation Thrift Society Limited (a welfare society functioning under the CPSTL) for the year ended 31 December 2015 had not been received. However, as per the audited financial statements for the year ended 31 December 2014, the Company had recorded total assets and total liabilities as Rs.1,390,983,174 and Rs.2,126,559,556 respectively. Further, the Company had recorded a negative unrestricted reserve balance of Rs. 1,410,978,763 which had contributed to the negative accumulated reserves of Rs. 735,576,382. However, 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.

(ii) Further, the shortfall of funds attributable to the companies, Ceylon Petroleum Corporation and the CPSTL could not be determined due to non-availability of the said information in the financial statements of the Thrift Society Ltd. Moreover, provision for the shortfall of funds attributable to members of the CPSTL had not been shown in the financial statements of the Company, as the Board of the CPSTL had decided to take over this liability of the Society from the books of accounts of the CPSTL.

(iii) Based on the confirmation received, the amount due from related parties was disputed by Rs. 336 million for which an allowance for impairment had been made in the financial statements for only Rs. 164 million.

2.2.2 Financial Statements of the Corporation

2.2.2.1 Going Concern of the Corporation

Attention is drawn to the matter that the operations of the Corporation had resulted a pre-tax net loss of Rs. 20,176 million and a total comprehensive net loss of Rs. 21,896 million for the year 2015, and had a negative net assets position of Rs. 229,153 million at the end of the year under review. Further, the negative impact of exchange rate variation for the year under review, and also, 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 previous year, the heavy loss occurred during the year under review had resulted to further erosion of the net assets position of the Corporation. Thus, the ability of the Corporation to continue as a going concern without the financial assistance from the Government is doubtful.

2.2.2.2 Compliance with Sri Lanka Accounting Standards (LKAS)

The following observations are made.

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

(i) Tax payable on other income of the Corporation for the years of assessment 2011/2012 to 2014/2015 amounting to Rs. 925 million had been recognized as expenditure for the year under review, instead of correcting that error retrospectively. As a result, the tax expenses for the year under review had been overstated by similar amount.

(ii) Errors relevant to the Employee Provident Fund (EPF) and Employee Trust Fund (ETF) amounting to Rs. 26,026,697 and Rs. 2,943,012 respectively, occurred during the year 2010 and revealed in the year 2015, had been adjusted during the year under review in contrary to the provisions in the Standard, and as a result, EPF and ETF expenses had been understated by similar amounts. Further, documentary evidence relating to those adjustments were not made available for audit.

(b) LKAS 12 – Income Tax

(i) The Corporation should have recognized deferred tax assets/liabilities for all temporary differences except for the incidents prescribed in the Standards. However, the Corporation had not recognized the deferred tax assets/liabilities in the financial statements.

(ii) The Corporation had recognized a sum of Rs. 1,559 million as tax expense during the year under review without explaining the relationship between tax expenses and accounting profits in accordance with the requirements of the Standard.

(c) LKAS 19 – Employee Benefits

According to the accounting policy No. 1.3 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 was permitted to use only for Small and Medium-sized Enterprises (SMEs). Accordingly, the requirement of provision for gratuity in terms of the Standard had not been followed.

(d) LKAS 24 – Related Party Disclosures

(i) Key management personnel compensations had not been properly disclosed in the financial statements.

(ii) The nature of the related party and the information about the transactions with regard to the income on investment property rented out to the line Ministry had not been properly disclosed in the financial statements.

(e) LKAS 32 – Financial Instruments: Presentation

(i) As per the request made by the Ministry of Finance, a sum of Rs. 10,000 million had been paid to the General Treasury on 31 December 2014 as a special fee, and out of which amounting to Rs. 250 million and Rs. 750 million had been charged as expenditure for the years 2014 and 2015 respectively and the outstanding balance of Rs. 9,000 million had been deferred for the period from 2016 to 2024. However, as per the financial statements, the said balance had been included in trade and other receivables and categorized as financial instruments as at 31 December 2015 in contrary to the Standard. Accordingly, trade and other receivables had been overstated by Rs. 9,000 million whereas the prepayments under non-current assets and current assets as at 31 December 2015 had been understated by Rs. 8,000 million and Rs. 1,000 million respectively.

(ii) Further, prepayments amounting to Rs. 269.4 million included in the trade and other receivables under the current assets as at 31 December 2015 had been categorized as financial instruments in contrary to the Standard.

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

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The **Commercial Bank** had filed a case against the Corporation at the Commercial High Court, Colombo claiming US$ 8,648,300 relating to the hedging transactions. However, required disclosures relating to the hedging transactions had not been made in the financial statements.

(g) LKAS 40 – Investment Property

The Corporation had recognized the investment property at cost. However, the following details, which should have been disclosed when the Corporation could not determine the fair value of the investment property reliably, had not been disclosed as notes to the financial statements in accordance with the Standard.

- A description of the investment property,
- An explanation of why fair value could not be determined reliably, and
- If possible, the range of estimates within which fair value is highly likely to lie.

2.2.2.3 Accounting Deficiencies

The following observations are made.

(a) The interest income on Treasury Bonds, calculated at coupon rates, amounting to Rs.264.3 million receivable for the year 2014 had been debited to the other receivable account and credited to the interest income account instead of crediting to the Investment in Treasury Bonds account under Non-current Financial Assets. In the meantime, the interest calculated based on effective interest rate of return (EIRR) on Treasury Bonds amounting to Rs. 214.4 million had been credited to the interest income account and debited it to the Investment in Treasury Bonds account. Accordingly, Investment in Treasury Bonds account had been overstated by Rs. 264.3 million. Further, the Corporation had grossed up that interest income by adding notional tax credit amounting to Rs. 29.4 million and recognized as income for the year 2014. As a result, interest income had been overstated by Rs. 293.7 million and the income tax provision account had been understated by Rs. 29.4 million. Moreover, those errors had not been rectified during the year 2015 as well. Therefore, the revenue reserve had been overstated by Rs. 293.7 million; while the investment receivable account had been overstated by Rs. 264.3 million and the income tax provision account had been understated by Rs. 29.4 million in the year under review.

(b) Rental income from sales booths established at Corporate Owned Dealer Operated (CODO) outlets had been recognized on cash basis and accordingly, the rental income of the year 2014 amounting to Rs. 6.1 million received during the year 2015 had been recognized as income for the year 2015. As a result, the amount receivable for the year 2015 had not been recognized as income for the year under review.

(c) According to the information made available, it was observed that the interest income on fixed deposits relating to the year under review and some previous years amounting to Rs. 622 million had been accounted for in the financial statements as interest income for the year under review. Following observations are made in this connection.

(i) According to the ledger accounts, a fixed deposit amounting to US $ 7.5 million had been maintained at the Bank of Ceylon since 22 August 2013 by the Corporation. However, interest income had been calculated only for 70 days in the year 2015 and recognized in the accrued interest income. The information relating to the interest income for the previous periods was not made available to audit. Accordingly, completeness and accuracy of the interest income were not ensured in audit.

(ii) The Corporation had invested a sum of Rs. 1,102,676,727 in fixed deposits (FD) at the Bank of Ceylon on 24 September 2013 with the consent of reinvesting the interest thereon in the same FD account until such time that it would be withdrawn. Accordingly, a sum of Rs. 98,241,638 had been reinvested and accounted for as fixed deposit up to 24 December 2014. However, despite the non-reinvesting the interest relevant to the period up to withdrawal of the FD in the year 2015, a sum of Rs. 1,245,202,499 had been withdrawn from the FD account on 25 September 2015, and accordingly, a sum of Rs. 44,284,133 had been over withdrawn from the fixed deposit account. As a result, both fixed deposit account and the interest income had been understated by Rs. 44,284,133 for the year under review.

(iii) An interest income of Rs. 174,557,534 receivable for the year 2014 had been erroneously debited to the interest income account and credited to other receivables account for the year under review. Accordingly, the interest income and the other receivables had been understated by the same amount.

(d) The Corporation had retained a long term fixed deposit having a balance of Rs.5,000,000 and the interest income thereon had not been recognized as income of the Corporation. However, information relating to that income was not made available to audit. Therefore, the accuracy and completeness of that interest income could not be ensured in audit.

(e) The Corporation had spent a sum of Rs. 2,116.18 million for the “Relocate of Crude Oil Pipe Line – Colombo Port Expansion Project” in the year 2011 and it had been included as plant and machinery in the assets and capital project in progress under the property, plant and equipment of the financial statements for the year under review. However, details of the progress of that project and the reasons for not capitalization of that amount were not made available to audit.

(f) According to the information made available, the Corporation had incurred a sum of Rs. 5,071.7 million for the project of the construction of aviation fuel storage facility and fuel hydrant system (outside the apron area) at the Hambanthota International Airport at Maththala, and that project had been substantially completed and handed over to the Corporation on 22 June 2014, and the "Taking over certificate" had been issued on 16 July 2014. Accordingly, the operations of the fuel hydrant system had been commenced with effect from 22 June 2014. The following observations are made in this regard.

(i) Some parts of the machinery of property, plant and equipment had been depreciated separately at different dates.

(ii) The depreciation rates and the dates applied by the Corporation for the computation of depreciation, and the useful life time of the relevant items of property, plant and equipment were not comparable. As a result, differences observed between the amounts of depreciation calculated based on estimated useful life time and the actual amounts provided in the financial statements of the year under review and the previous year (as per SAP system) were amounting to Rs. 128,576,712 and Rs. 36,487,486 respectively.

2.2.2.4 Unreconciled Differences

The following unreconciled differences were observed between the amounts shown in the financial statements of the Corporation and its Subsidiary for the year ended 31 December 2015.

Items	Year	Amount as per the Individual Financial Statements of the		Difference
		Corporation	CPSTL	
		Rs. million	Rs. million	Rs. million
Related Party Transactions:				
Terminal (throughput) and transport charges/ Service for oil storage and distribution	2015	10,660.4	10,234.4	426.0
	2014	9,772.7	10,185.5	412.8
Balance Outstanding:				
Balance due to/ from (Related party transaction)	2015	5,828.7	6,164.2	335.5
	2014	5,605.7	7,237.6	1,631.9

The following observations are also made in this connection.

(a) In consolidation process, only sums of Rs. 10,660.4 million and Rs. 9,772.6 million had been eliminated for the years of 2015 and 2014 respectively with regard to the throughput (terminal) charges and transport charges included under the related party transactions. According to the reconciliation prepared by the Corporation, there were five items of transactions amounting to Rs. 338 million as disputes.

(b) Further, according to the reconciliation statement prepared by the Corporation in connection with the related party balances shown in the financial statements of the Corporation with the corresponding balances shown in the financial statements of the Subsidiary, a balance amounting to Rs. 172 million had been disputed.

2.2.2.5 Accounts Receivable and Payable

Total trade receivables as at 31 December 2015 was Rs. 18,786.8 million consisting Rs.4,313.5 million and Rs. 14,473.2 million due from government institutions and private institutions respectively. However, the total dues as at the end of the year under review had decreased by 49 per cent when compared to the previous year outstanding balance of Rs.37,060 million.

Age analysis of accounts receivable as at 31 December 2015 is shown below.

Customer wise	Total Dues as at 31 December 2015	Age analysis of dues as at 31 December 2015					
		Below one year	1-2 years	2-3 years	3-4 years	4-5 years	Over 5 years
	Rs.	Rs.	Rs.	Rs.	**Rs.**	Rs.	Rs.
Dealers	814,620,088	783,717,567	10,981,377	3,267,723	1,379,217	252,922	15,021,283
Aviation	9,477,595,864	7,335,533,925	5,173,970	23,376,709	2,111,097,630	2,326,616	87,015
Power Plants	4,497,947,417	3,500,944,742	243,391,845	753,610,830			-
Government Customers	1,593,523,430	928,829,094	480,740,633	61,544,346	51,100,014	46,952,425	24,356,918
Private Consumers	494,299,036	206,643,766	21,662,297	22,568,177	25,412,079	24,665,945	193,346,772
Agro Chemical	23,048,258	16,350,064	(421,790)	28,210	(30,360)	81,988	7,040,145
Others	1,885,747,417	1,884,321,245	(4,081,296)	1,362,001	65,474	201	4,079,793
Total	**18,786,781,510**	**14,656,340,403**	**757,447,036**	**865,757,996**	**2,189,024,054**	**74,280,097**	**243,931,926**

The following observations are made.

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

(b) Even though Sri Lankan Airlines Ltd. (SLA) and Mihin Lanka (Pvt.) Ltd. were contract customers, the Corporation had incurred losses up to the year 2014 on sale of Aviation Turbine Fuel to those companies and the settlement of outstanding fuel bills were also very poor due to their weak financial performance. However, the Corporation was able to reduce the outstanding balances as at 31 December 2015 from Rs. 22,239.1 million in the year 2014 to Rs. 9,156.7 million in the year 2015. The trend of the outstanding balances since 2010 is given below.

Name of the Company		Outstanding Balance as at 31 December					
	31 July 2016	2015	2014	2013	2012	2011	2010
	Rs. Mn	Rs. Mn.	Rs. Mn.	Rs. Mn.	Rs. Mn.	Rs. Mn.	Rs. Mn.
SriLankan Airlines Ltd	10,709.30	8,607.36	20,900.35	29,519.68	25,890.12	12,351.43	541.54
Mihin Lanka (Pvt.) Ltd	247.50	549.37	1,338.73	4,313.68	3,416.10	1,227.02	361.24
Total	**10,956.80**	**9,156.73**	**22,239.08**	**33,833.36**	**29,306.22**	**13,578.45**	**902.78**

(c) The Corporation had not signed an Aviation fuel supply agreement with SriLankan Airlines Limited, and therefore, there was a default risk due to lack of legal right to the Corporation. Further, the outstanding balance of Rs. 8,607.4 million as at 31 December 2015 had increased up to Rs. 10,709.3 million as at 31 July 2016.

(d) As per the audit examinations carried out in relating to provisions for bad debts of the Corporation for the year ended 31 December 2015, the following observations are made.

(i) The Corporation had made a specific provision of Rs. 52,099,042 for bad debts, which was outstanding for the period ranging from one year to 29 years as at 31 December 2015, and out of that a provision of Rs. 8,219,208 had been made for the year 2015. Details are as follows.

Name of the Customer	Provisions for bad debts	
	As at 31 December 2015	As a percentage of total provision
	Rs.	
Dealers & Kerosene Agents	26,900,233	52
Estate & Pvt. Consumers	9,264,132	17
Govt. Departments & Corporations	4,625,679	09
Aviation	4,032,957	08
Agro Chemical & Stockiest	7,276,041	14
Total	**52,099,042**	**100**

(ii) Provisions for bad and doubtful debts had been made for dealers and kerosene agents as at 31 December 2015 was Rs. 26.9 million, and out of that a sum of Rs 8.1 million or 30 per cent was represented by one dealer. The said dealer had failed to settle the outstanding amount of Rs. 7,817,395 as at 31 December 2014, and total outstanding amount as at 31 December 2015 was Rs. 8,102,409 (with interest). The following observations are also made in this regard.

- According to the cheques on delivery customer (COD) basis applied by the Corporation before 2015, when a cheque was returned and the customer was failed to settle the amounts due, that customer would be categorized as a hard cash customer, and a penalty of Rs. 1,000 was charged for each returned cheques. Further, once the outstanding balance was settled later, that customer would be categorized again as a COD customer. According to this poor credit control, some customers had exploited such opportunities in favour of them and obtained maximum benefits.

- According to the audit test carried out in this regard, it was observed that the above mentioned customer had been granted the special credit facilities despite the continuous failure to settle the outstanding balances within the given credit period. Further, according to the information made available, the Marketing Manager of the Corporation had provided inappropriate credit facilities to the said customer, and as a result, that customer had exploited such opportunities and obtained maximum benefits for several years. Accordingly, the Corporation had incurred a loss of Rs. 8,102,409 during the year 2015.

- Even though the then Additional Finance Manager (AFM) had pointed out that there was a default risk, due to continuous failure on settlement of outstanding balances for several years with the existing COD facility, the Corporation had not taken necessary actions to mitigate that risk, and instead, the Marketing Manager had granted more credit facilities without evaluating the dealer's financial viability and the previous payment records.

- Despite the avoidance of payment for bills and dishonour of cheques, the Marketing Manager had arranged some other opportunities such as Lord to Lord facility (settles the amount once other load comes) to that customer for two months period without any guarantee.

- According to the request made by the dealer on 06 March 2013, the Managing Director had given the approval to increase the credit limit up to Rs. 3,641,008 and 3 days credit period for 45 days with the condition of providing a bank guarantee within 45 days. Further, the Deputy General Manager (Finance) had again approved the credit period for two month on 22 April 2013, and it was further increased by three months from 20 June 2013 without obtaining a bank guarantee.

- The outstanding balance as at 21 January 2014 was Rs. 7,224,416 when he had stopped the market activities. However, on the request made by him, the Corporation had continued to provide services without a bank guarantee, and with an agreement to settle the outstanding balances. However, further two cheques issued by him had been returned on 21 October 2014. As a result, the outstanding balance with interest as at 31 December 2015 was Rs.8,102,409.

2.2.2.6 Hedging Transactions

As per the audit examination carried out pertaining to the hedging transactions of the Corporation, it was observed that the total loss incurred to the country on this transactions as at 31 December 2015 was Rs. 14,062 million.
The following observations are made.

(a) According to the 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 and a sum of US Dollars 27 million (Rs.3,864.37 million) had been paid to the Deutsch Bank AG on 04 August 2016 (had made provision as at 31 December 2015) under the Deed of Settlement entered into between the parties. According to the information made available, the total loss incurred by the Corporation as at 31 December 2015 was Rs. 13,641.12 million.

(b) The Central Bank of Sri Lanka (CBSL) had incurred the legal expenses of Rs. 570.6 million with regard to this transaction of the Corporation and out of that a sum of Rs.567.5 million had already been reimbursed to the CBSL by the Corporation during the period 2011 to 2014.

(c) In addition to that, the CBSL had paid a sum of Rs. 404.3 million up to 31 December 2015 for the services obtained from the foreign lawyers those who had appeared in the arbitration proceedings initiated by the Deutsche Bank against the Government of Sri Lanka, and further, the CBSL had made a provision of Rs. 13.1 million in this regard during the year 2015.

(d) Moreover, the **Commercial Bank** had filed a case at the Commercial High Court, Colombo against Corporation claiming US$ 8,648,300.

(e) A formal investigation had been initiated against the then DGM (Finance) of the Corporation who had sent on compulsory leave since 2008, and his service has been terminated on 04 August 2016. However, no any other investigation had been initiated against the persons who were responsible for those transactions by the Corporation.

2.2.2.7 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, 04 employees, appointed for covering up duties, had been working in those vacant posts for the period ranging 08 months to 04 years at the end of the year under review.
(c) Public enterprises Circulars No. FP/06/35/02/01 dated 04 November 2013 and No. PED 03/2016 dated 29 April 2016.	The Corporation had borne the PAYE tax expenditure of its employees amounting to Rs. 213,986,411 without deducting from their personal emoluments for the year under review.
(d) Guideline 5.4.12 of the Government Procurement Guidelines.	After making payments to settle the VAT liability, details of such payments shall be informed to the Commissioner General of Inland Revenue with a copy to the Auditor General, on or before the 15th day of the following month. However, such details had not been submitted to the Auditor General by the Corporation up to 31 July 2016.
(e) Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka.	
Financial Regulations 135	Financial authority had not been delegated since 2007.

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 loss of Rs. 20,176 million as against the corresponding pre-tax net profit of Rs. 1,129 million for the preceding year, thus indicating a deterioration of Rs. 21,305 million in the financial results. The negative impact of the exchange rate variations, increase in the selling and distribution expenses and finance expenses, and the increase of taxes were the main reasons attributed for this deterioration.

Even though the pre-tax net loss for the year under review was Rs. 20,176 million, the contribution of the Corporation to the Country during the year under review was Rs.78,440 million. The contribution of the Corporation to the Country during the year under review and in the previous four years is as follows.

	2015	2014	2013	2012	2011
	Rs. Mn.	Rs. Mn.	Rs. Mn.	Rs. Mn.	Rs. Mn.
Net Profit/(Loss) After Taxes	**(21,735)**	**1,129**	**(7,889)**	**(97,181)**	**(94,357)**
Add:					
▪ Personnel Emoluments	4,530	3,727	3,572	2,658	2,610
▪ Taxes Paid to the Government					
· Income tax	1,559	-	-	-	-
· Nations Building Tax (NBT)	2,074	2,936	2,652	3,147	1,897
· Customs Duty	44,713	11,730	10,187	9,735	440
· Value Added Taxes (VAT)	1,280	2,741	1,685	1,538	1,337
· Excise Duty	35,687	30,205	25,148	26,089	23,935
· Ports Authority Levy (PAL)	8,648	15,289	15,823	20,810	14,537
· Other taxes	-	447	-	-	-
▪ Special Fee*	750	250	-	-	-
▪ Depreciation	934	634	485	516	417
Total Contribution	**100,175**	**67,959**	**59,552**	**64,493**	**45,173**
Value Addition	**78,440**	**69,088**	**51,663**	**(32,688)**	**(49,184)**

*** Special Fee** – The Corporation had paid a sum of Rs. 10,000 million to the General Treasury on 31 December 2014 as a special fee, and out of which amounting to Rs. 250 million and Rs. 750 million had been charged as expenditure for the years 2014 and 2015 respectively and the outstanding balance of Rs. 9,000 million had been deferred for the period from 2016 to 2024.

3.2 Analytical Financial Review

The following observations are made.

(a) Profitability

The operations of the Corporation had resulted in a markup of 11.75 per cent for the year under review thus indicating an improvement of 6.70 per cent as compared with the markup of 5.05 per cent in the preceding year. Similarly, the gross profit for the year under review had increased by Rs. 14,389 million or 57 per cent as compared with the corresponding gross profit of Rs. 25,227 million in the preceding year. These improvements are summarized and shown below.

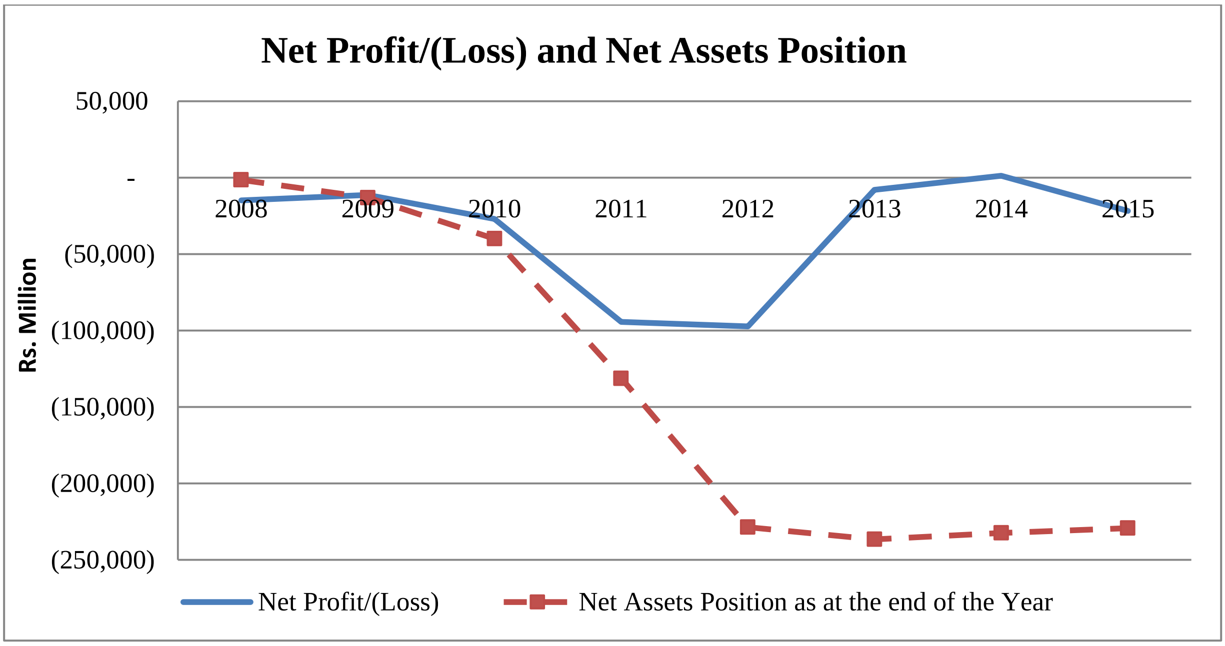
Description	For the year ended 31 December		Change [Favourable/ (Unfavourable)]	Percentage
	2015	2014 Restated		
	Rs. million	Rs. million	Rs. million	
Revenue	376,734	525,182	(148,448)	28.3
Cost of Sales	(337,118)	(499,955)	162,837	32.6
Gross Profit	**39,616**	**25,227**	**14,389**	**57.0**
Other Income	4,234	3,506	728	20.8
Selling and Distribution Expenses	(13,618)	(11,533)	(2,085)	18.1
Administration Expenses	(2,814)	(4,904)	2,090	42.6
Operating Profit	**27,418**	**12,296**	**15,122**	**123.0**
Exchange Rate Variation	(32,841)	(967)	(31,874)	3,296.2
Finance Expenses	(15,049)	(13,980)	(1,069)	7.6
Finance Income	4,910	4,030	880	21.8
Hedging Expenses	(3,864)	-	(3,864)	$\propto$
Special Fee	(750)	(250)	(500)	200
Profit/(Loss) Before Income Tax	**(20,176)**	**1,129**	**(21,305)**	**1,887.1**

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

The net profit/ (loss) and the net assets position of the Corporation for the year 2015 and previous seven 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	(94,357)	(131,236)
2012	(97,181)	(228,545)
2013	(7,947)	(236,529)
2014*	1,129	(232,257)
2015	(21,735)	(229,153)

* Restated



The main contributory factors for the continuous financial losses and capital erosion of the Corporation were revealed as sale of petroleum products other than petrol and super diesel at domestic retail market below the import cost and locally refined cost, exchange rate variations due to non-settlement of bills on time and depreciation of the Sri Lanka Rupee against US Dollar, increase of finance expenses due to high level of borrowings from banks, increase of custom duties, loss on export of Naphtha and Furnace Oil (bottom products of refinery) due to inefficiency of refinery operations with low margin and poor yields, and as a result importation of refined petroleum products to meet the demand of the country, heavy losses incurred on Hedging transactions, provision of fuel (Furnace Oil and Naphtha) at subsidized rate to Ceylon Electricity Board (CEB), 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 2014 and once in 2015 in line with decrease of international fuel prices. 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 years of 2014 and 2015 are as follows.

Petroleum Products	Revised Price per Liter with effect from				
	28 Nov. 2015	**22 Jan. 2015**	**06 Dec. 2014**	**17 Sep. 2014**	**23 Feb. 2013**
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Petrol 95 Octane	128.00	128.00	158.00	165.00	170.00
Petrol 92 Octane	117.00	117.00	150.00	157.00	162.00
Lanka Auto Diesel	95.00	95.00	111.00	118.00	121.00
Lanka Super Diesel	110.00	110.00	133.00	140.00	145.00
Lanka Kerosene	49.00	65.00	81.00	86.00	106.00
Lanka Industrial Kerosene	88.00	94.00	110.00	115.00	115.00

(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	2015	2014 (Restated)
Profitability Ratios		
Gross Profit Ratio (GP) (%)	10.52	4.80
Operating Profit Ratio (%)	7.28	2.34
Net Profit/(Loss) Ratio (NP) (%)	(5.77)	0.21
Liquidity Ratios		
Current Assets Ratio (Number of times)	0.31:1	0.34:1
Quick Assets Ratio (Number of times)	0.21:1	0.19:1
Working Capital (Rs. million)	(295,113)	(271,581)
Investment Ratios		
Return on Assets (ROA) (%)	(10.9)	0.62

The following observations are made in this regard.

(i) The gross profit ratio had improved by 5.71 per cent whereas the net profit ratio had deteriorated by 5.57 per cent during the year under review as compared with the previous year.

(ii) The working capital position of the Corporation in 2015 was slightly declined as compared with the previous year. The main contributory factors for this feeble condition were increase of short term borrowings and decrease of the inventories and trade and other receivables.

4 Operating Review

4.1 Performance

(a) The domestic retail prices of petroleum products had been revised upward continuously up to September 2014 in order to address the financial difficulties of the Corporation. In the meantime, the domestic retail prices of petroleum products had been reduced twice during 2014 and 2015 as international oil prices had continued to be on a declining trend. However, the above price revisions had not reflected the actual reductions in international market prices in full. Moreover, the Corporation had continuously sustained losses from following petroleum products.

Sector	Net Losses Sustained for the Year			
	2015	2014	2013	2012
	Rs. Million	Rs. Million	Rs. Million	Rs. Million
Power Generation				
Fuel Oil 1500	252	299	1,240	34,959
Industrial & Domestic				
Fuel Oil 1500	262	69	350	2,003
Domestic Kerosene	3,860	2,715	2,449	3,525
Export				
Naphtha	827	1,799	-	-
Fuel Oil	5,346	1,627	-	-

Further, the Corporation had incurred losses of Rs. 26,530 million and Rs. 2,787 million from petrol 92 octane and 95 octane respectively due to increase of customs duty on petrol by Rs. 20 (from Rs. 15 to Rs. 35) per liter in December 2014, and the revision of domestic selling prices downward in January 2015.

Profitability on petroleum products (per liter) for the year 2015

Product	**Selling Price per Liter**	**Sales Revenue Net of Dealer Margin per Liter**	**Cost of Sales per Liter**	**Gross Profit per Liter**	**Total Cost per Liter**	**All Taxes Included in the Total Cost per Liter**	**Net Profit/ (Loss) per Liter**	**Total Net Profit/ (Loss) for the year**
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	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs. Mn.
Petrol 95	128.00	125.51	103.73	21.78	151.48	66.83	(25.97)	(2,787)
Petrol 92	117.00	115.13	96.56	18.57	141.83	66.56	(26.70)	(26,530)
Auto Diesel	95.00	93.68	71.37	22.31	90.52	16.35	3.17	5,647
Super Diesel	110.00	108.23	75.75	32.48	94.98	16.28	13.24	734
Kerosene	59.00	57.80	66.84	(9.04)	82.60	0.04	(24.80)	(3,860)*

* Kerosene subsidy of Rs. 3,860 million had been received from the General Treasury during the year under review.

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

"Once the cost reflective pricing mechanism is introduced losses from those products can be eliminated."

(b) The agreement entered into between a private gas company and Ceylon Petroleum Corporation in respect of liquid petroleum gas sales had expired on 20 October 2006. However, the Corporation had supplied liquid petroleum gas to that company continuously without entering into a fresh agreement or renewing the earlier agreement. In addition to that, the Corporation had supplied liquid petroleum gas to another private company without entering into an agreement. However, a LP Gas filling equipment (Mobile LPG Filling Plant), having a filling capacity of 60 tons of LP Gas to 13.5kg LPG Cylinders in 10 hours, had been 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 July 2015, and that asset had remained idle since then.

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

"After failing all options, CPC finally has decided to enter into the LPG retail marketing business and hence, simultaneously has tried to commission the machine by bringing in its original supplier, who identified some minor repairs necessitated due to rodent attacks. This option is now being seriously considered by CPC, giving it high priority. CPC has already called for expressions of interest from the parties concern for this business."

4.2 Management Weaknesses

The following observations are made.

(a) Enterprise Resource Planning (ERP) System

(i) 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.

(ii) Narrations for adjustments made in ledger accounts had not been clearly put down, and accordingly, it was difficult to identify the adjustments made to the ledger accounts during the year under review.

(b) Collection of Monthly Utilized Fee (MUF)

As per the Board decision No. 38/1140 of 29 October 2013, the Board had approved to charge Monthly Utilized Fee (MUF) calculated at 35 per cent of the average monthly commission on 2.25 per cent per litre of any product of the previous year earned by all Corporate Owned Dealer Operated dealers (CODO) and Treasury Owned Dealer Operated dealers (TODO) as the monthly rental (Monthly Utilized Fee) with effect from 01 January 2014. However, the Corporation was unable to initiate the said scheme up to 30 June 2016 due to delays in preparing special dealer agreements. Further, out of 248 numbers of CODO dealers, MUFs amounting Rs. 23 million had been recovered only from 12 dealers during the year under review.

(c) Increase of Borrowings from the Banking Sector

The Corporation had increased its borrowings from the banking sector to finance its oil bills and it had resulted to increase the sustained losses of the Corporation and to erode further the net assets position of the Corporation. Accordingly, the Corporation had to incur huge finance cost continuously during the last consecutive years due to maintaining the significant amount of borrowings as depicted below.

Year	Balance of Loans & Borrowings as at 31 December	Bank Borrowings during the Year	Finance Cost	Annual Profit/(Loss) on Ordinary Activities
--------	---------------	---------------	----------	------------------
	Rs. Bn.	Rs. Bn.	Rs. Bn.	Rs. Bn.
2015	267.926	356.57	15.05	(21.74)
2014	249.139	376.61	13.98	1.13
2013	228.758	406.85	18.54	(7.89)
2012	213.161	399.52	18.36	(97.18)
2011	150.622	310.06	9.00	(94.36)
2010	46.626	168.02	6.86	(26.92)

(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 these 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 Chairman of the Corporation stated in this regard as follows.

“Action has been taken to call tenders to construct two new transfer lines having diameters of 18" and 14" respectively. These lines will be starting from Dolpin Tanker Birth (DTB) (with two new loading arms) and end up at Kolonnawa oil installation of CPSTL. In addition, the 12" line which is currently under repairs will also be completed, once the segment where horizontal drillings are needed to be done is carried out.”

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 had not been implemented up to 31 December 2015. The current position of the Cross country pipelines – Fuel lines from Colombo Port to Kolonnawa Depot is shown below.

Diameters of the Line (Inches)	Product	Current Position
10	Gas Oil	Working condition
10	Other White Oil	Not Working
10	Naphtha Oil	Not Working
12	Naphtha Oil	Not Working. CPSTL is replacing the line (2 Km have already been completed)
14	Fuel Oil	Working condition

(e) Trincomalee Tank Farm

The Tank Farm contained of 100 Oil Tanks, each having a capacity of 12,500 cubic meters (m^3) (10,000 MT) and other associated facilities, had been constructed in 1930. The land with an extent of 358,553 hectares belonged to the Tank Farm had been given on lease basis by the Government of Sri Lanka to the Commissioners of the Lord High Admiralty of the British Government for a period of 999 years before gaining independence to Sri Lanka. In 1961 at the request of the Government of Sri Lanka, the Corporation had paid Sterling Pounds 250,000 in three installments and taken over the possession of Land, Tank Farm, Buildings and other equipment with effect from 01 April 1964. Nevertheless, no legal documents had been obtained from the Government for the above land.

In 2003, the Government of Sri Lanka had entered into an agreement with Lanka Indian Oil Company (LIOC) and the Corporation to lease out the storage facilities and the land to the LIOC for a period of 35 years and lease agreement should be executed within 6 months from the date of agreement. However, the Corporation had not yet entered into any lease agreement and no related lease rentals had been recovered from the LIOC for the use of storage facilities.

In 1942 one oil tank had been totally destroyed by the war. At present out of 99 oil tanks, 14 tanks are currently used by the LIOC and balance 85 tanks had been abandoned. During the Visit of Prime Minister of India to Sri Lanka in March 2015, it had been agreed that Lanka IOC and Ceylon Petroleum Corporation would jointly develop the China Bay upper tank farm. Then Joint Task Force (JTF) had been established with effect from 29 April 2015 and JTF consist of 10 Members (4 members from India and 6 members from Sri Lanka) and appointed Secretary, Ministry of power & Energy as Chairperson.

(f) Service Agreement between the Corporation and CPSTL

A service agreement between the Corporation and CPSTL was not made available, and therefore, a proper understanding of the services provided by each organization was not clearly defined. Further, the Corporation had not properly designed and implemented monitoring policies and procedures, including performance indicators, to ensure the provision of petroleum products in required quality and quantity by the CPSTL.

(g) Stock Review Committee

The Stock Review Committee consisted of members from the Corporation, CPSTL, JCT Oil Bank and Lanka Indian Oil Company, members of Ceylon Electricity Board (CEB) and an officer from the line Ministry and its meetings had been held in every week. However, The CPC had not maintained proper records relating to the stock levels, i.e. re-order level, maximum level, minimum level, and re-order quantity etc. in each petroleum products. The order quantity of petroleum products was decided solely based on the stock quantity maintenance report submitted by the CPSTL and no any other documents with regard to the maintenance of stocks of petroleum products had been submitted to the Stock Review Committee of the Corporation. However, it was revealed that, since the introduction of SAP system, the Corporation was unable to extract data and produce stock related reports.

(h) Utilization of Muthurajawela Terminal

It was observed that Muthurajawela Terminal had not been optimally used in issuing petroleum products. Accordingly, the following benefits had not accrued to the Corporation from the investment made.

- Savings port charges
- Shortening lay time of vessels
- Reducing demurrage charges
- Savings delivery costs
- Reducing human resource costs
- Savings delivery loss at the point of discharging of fuel through pipelines
- Reducing traffic congestions in delivering fuel by bowsers.

(i) Fisheries Coupon System

With the intention of reducing the negative consequences on fisheries industry resulted by revising the fuel prices, the Corporation with the collaboration of Department of Fisheries and Aquatic Resources had initiated a programme to give a fuel subsidy to the owners of the fisheries boats with effect from March 2012. The subsidy coupons had been distributed among the owners of the fisheries boats by the Department of Fisheries and Aquatic Resources, and it had been stopped from September 2013. The Corporation had selected dealers to distribute fuel for fisheries coupons and accordingly, the fisheries boat owners had obtained fuel by producing the coupons from that selected regional dealers. The Corporation had settled the due amounts to dealers when they submitted such fisheries coupons to the Corporation. Accordingly, the amount incurred by the Corporation had been reimbursed from the General Treasury through the Department of Fisheries and Aquatic Resources. The following observations are made.

(i) According to the information made available, the amount paid by the Corporation, as at 31 December 2015, to the dealers with regard to the fisheries coupon programme was Rs. 4,371,312,889. However, the Corporation had reimbursed a sum of Rs. 4,549,775,000 from the General Treasury in three instalments.

Although a sum of Rs. 178,462,111 had been excessively reimbursed by the Corporation, it was not settled to the General Treasury even up to 31 July 2016.

(ii) The following deficiencies were observed with regard to the fisheries subsidy distribution process of the Corporation.

- Allowable amount of fuel for the fisheries coupons had not been obtained by the fisheries boats owners and instead, they had obtained only the amount of fuel equivalent to the face value of the coupons (subsidy) from dealers.

- There were instances that the fisheries boats owners had obtained cash from dealers by discounting fuel coupons instead of obtaining fuel, and the dealers had submitted those coupons to the Corporation and got reimbursed the total amount of the value of the coupons.

- There were instances that the amounts over the reimbursable had been credited to the distributors' accounts. According to the test check a sum of Rs. 9,759,350 had been credited to the distributors' accounts over the amount reimbursable as at 31 December 2015. According to the comments of the Chairman of the Corporation, a part of such over reimbursements had been settled later.

- In some instances that the money had been credited to dealers' accounts without obtaining the fisheries coupons and later they had provided coupons to set off such amounts. In one of such instances, a sum of Rs. 24,310,000 had been credited to the distributors' accounts and within a period of ranging 01 to 12 months the Corporation had settled that amount by journal entries using coupons received subsequently.

(iii) Instances of selection of unsuitable dealers for distribution of fuel for fisheries coupons had been observed. For instance, a filling station located in Hakmana area, which was 24 km away from the coastal area in Matara, had been selected for distribution of fuel for fisheries coupons.

(iv) There was a difference of Rs. 81,886,701 between the actual value of the fisheries coupons issued to the fisheries boats owners and the value of coupons submitted by the dealers to the Corporation for settlement.

(v) According to the test check carried out on the amount of fuel bills settled to a dealer, the following deficiencies were observed.

- Even though the Corporation had settled fisheries coupons subsidy amounting to Rs. 321 million to the above dealer during the period from March 2012 to September 2013, he had not obtained the allowable quantity of fuel from the Corporation during that period.

- According to the fisheries coupons procedure of the Department of Fisheries and Aquatic Resources, the dealers were not allowed to issue fuel to the fisheries boat owners of other districts. Even though the filling station of the above mentioned dealer had been located in Trincomalee District, he had obtained fisheries coupons from the fisheries boat owners of Mullaitivu and Jaffna Districts at discounted prices (without issuing fuel), and submitted to the Corporation for the settlement of fuel bills. Accordingly, fisheries coupons amounting to Rs. 17,508,875 had been submitted to the Corporation for settlement but, it had not been settled by the Corporation. Further, some other fisheries coupons amounting to Rs. 6,281,250 had been retained by him as at 30 June 2016 because the Corporation had rejected to accept them.

- As per the internal audit investigation conducted in this regard, it was revealed that the Corporation had paid a sum of Rs. 2,658,015 to the above dealer on fraudulent coupons presented by him. However, the Corporation had not initiated any investigation against the responsible officers in this regard.

(j) Bitumen business

The bitumen business in the country had been solely done by the Corporation up to January 2004, and Lanka Indian Oil Company (LIOC) had been granted the approval for importation and sales of bitumen with effect from 21 January 2004. In addition, according to the Cabinet Decision dated 16 November 2011, the Ministry of Petroleum Industries, by obtaining a no-objection letter from the Corporation, had granted the permission to the Road Development Authority (RDA) to import bitumen to the country. Accordingly, under the recommendation of the Ministry of Ports and Highways, the permission had been granted to fifteen other private companies to import bitumen for their identified projects.

Mainly, two types of bitumen, namely Asphalt 80/100 and Asphalt 60/70, had been imported and sold by the Corporation during the past period. As per the audit test carried out on bitumen business of the Corporation during the year under review, the following deficiencies were observed.

(i) A quantity of 140,123 barrels of bitumen Asphalt 60/70 had been received during the year 2015 in response to the import orders placed by the Corporation in the last quarter of the year 2014, and accordingly, it was revealed that the importation quantity of bitumen had increased by 28,015 barrels or 25 per cent during the year under review when compared with the previous year. Likewise, the sales quantity of the same product had decreased by 80,258 barrels or 67 per cent when compared with the preceding year. As a result, closing stock of that product had increased by 101,195 barrels or 336 per cent during the year under review.

(ii) Information regarding the country's requirement of bitumen for the year under review, and the details of the quantity of bitumen imported by the Road Development Authority during the year under review had not been maintained by the Corporation or by the Ministry. Therefore, the Corporation was unable to properly estimate the requirement of the bitumen to be imported by the Corporation during the year under review. As a result, unnecessary stock had been maintained by the Corporation.

(iii) The Corporation had not designed and implemented an appropriate stock control system and accordingly, re-order level, re-order quantity, minimum level and maximum level of stock had not been maintained for bitumen. As a result, stock damages and incurring losses by selling of bitumen at lower prices due to inappropriate stock controls were observed.

(iv) A Procurement Plan for the bitumen was not made available to audit, and also, such a Plan had not been included in the Action Plans of the Corporation prepared for the years of 2015 or 2016.

(v) The Corporation had received 147,180 barrels of bitumen (Asphalt 60/70) amounting to US $ 13,350,480 during the period from December 2014 to September 2015, and out of that 129,802 barrels (23,364 metric tons) had been remained in the stocks as at 31 December 2015. However, due to drop in the price of bitumen in the market, the Corporation was unable to sell that bitumen stock at a profit margin, and accordingly, that stock was remained as slow moving items until the price reduction by Rs. 6,480 (from Rs. 15,480 to Rs.9,000) per barrel with effect from 22 January 2016. The Corporation had sold 88,833 barrels of bitumen during the period from 01 February to 31 July 2016 at a loss of Rs. 3,504.60 per barrel, and accordingly, the estimated loss incurred by the Corporation during that period was amounting to Rs. 311.3 million.

(vi) The closing stock of the bitumen of Asphalt 60/70 as at 31 July 2016 had included 36,679 barrels of bitumen, which had been purchased at a cost of Rs.485.9 million in 2014 and received up to September 2015. Accordingly, investing such a huge amount of money in the bitumen business, which was not a main business activity required to achieve the objectives of the Corporation, was a questioned in audit.

(vii) Even though there were no proper plans for stock level maintenance, sales targets, information relating to customer demand and market position, etc., the Corporation had purchased 55,556 barrels (10,000 metric tons) of bitumen, Asphalt 60/70 at a cost of USD 2,360,000 (Approximately Rs. 344.1 million) on 15 March 2016, and that stock also was remained in the stocks as at 31 July 2016.

(k) Payment of Penalty

The Corporation had paid a sum of Rs. 57,736,913 to the Department of Customs on 20 June 2014 to settle the amount outstanding since 2002 for the purpose of commencing of bunkering operations and on the basis of reimburse that amount from the General Treasury. However, the Department of Customs had identified that this payment was made as a penalty. The following observations are made in this regard.

(i) The amount paid by the Corporation had not been reimbursed by the General Treasury up to 31 July 2016.

(ii) The bunker business had not been commenced even up to 31 July 2016.

(iii) According to the information made available, it was observed that 50 per cent of the above payment or a sum of Rs. 28,868,456 had been shared among the custom officers, and other 20 per cent or a sum of Rs. 11,547,383 had been allocated to the custom officers' welfare fund.

(iv) Even though there was an opportunity to set off that amount as the two institutions were Government institutions, the Corporation had not taken actions to appeal in accordance with the Sections of 154 and 165 of the Customs Ordinance.

(l) Agreement with the Ceylon Electricity Board (CEB)

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.

4.3 Operating Inefficiencies

(a) Refinery Operations

The existing 45 years old refinery, which was commissioned in 1969, is a basic refinery and 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 refineries operating with advanced technologies including facilities to produce petroleum products at lower cost and capabilities to upgrade bottom products to high value products such as petrol and diesel, whereby maximizing the refinery operating efficiency. However, the Corporation was unable 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. Even though preliminary feasibility study had been completed and the required land (35 acres) had been acquired for this purpose, the Corporation was unable to initiate the project yet due to insufficient financial strength to invest for this project. Total cost of the project was estimated at US$ 2.1 billion with a payback period of less than 8 years, and the Net Present Value (NPV) of the project would be US$ 1,535 million. Further, the expenditure incurred by the Corporation amounting to Rs. 837 million, which had been included in the assets and capital projects in progress under the property, plant and equipment as at 31 December 2015, was observed as an uneconomic transaction.

According to the information made available, the 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 and there were two regenerations for nearly another one month with low throughput operation during the year 2014. Therefore, it indicates that the refinery needs an urgent technical modification to avoid failures of old equipment and to avoid frequent regenerations while enhancing the profitability and operational flexibility.

(b) Bulk Sales of Fuel to Consumers

As per the audit test check on bulk sales of fuel to the consumers by the Corporation, the following deficiencies were observed.

(i) According to the information made available, the Corporation had given approval to dealers to use their own bowsers to transport fuel to their filling stations in 1996 for the purpose of reduce the complaints on incorrect quantity, unavailability of fuel distribution on time and problems of downgrading the product quality due to mixing of other inferior products.

(ii) Further, that procedure had been amended in 2008 by the Board decision No. 43/1073 of 23 June 2008 and the Corporation’s Internal Circular No.898 of 29 August 2008. Accordingly, dealers had been granted approval to transport fuel to consumers under the following terms and conditions.

- Distribution of fuel directly to the consumer.

- Invoices could be prepared on the name of the dealer.

- A commission of 2.5 per cent could be obtained, but the transport charges were not allowed.

- That sale was called as dealer’s bulk sale.

- It was allowed to get only diesel from the closest Bulk Depots, and terminals at Kolonnawa, Supugaskanda and Muthurajawela.

- Dealers, those who used their own bowsers to transport fuel to their filling stations and obtained transport charges from the Corporation, were not permitted for bulk sales.

(iii) However, due to some failures of the above mechanism, the following conditions had been introduced by the Marketing Manager of the Corporation by his letter No. MKT/13/35 dated 15 August 2013.

- Dealers can obtain diesel only from the Sapugaskanda Terminal

- Discounts were provided based on the sales, but transport charges are not allowed

Objectives of the Corporation by introducing the above new conditions were to save the throughput charges which needed to be paid to the CPSTL for storage and distribution facility, and to encourage optimum utilization of operational capacity of the Supugaskanda Terminal.

(iv) However, instead of distribution of fuel directly to the consumers from the Supugaskanda Terminal, a dealer had issued diesel to consumers in bulk quantities from his own stocks using two pumps (Pumps No. 04 and 05). Also, the dealer had purchased that fuel from bulk depots in Galle and Matara.

(v) Calibration of the above two dispensing pumps (Pumps No. 04 and 05), which had been used only for bulk sales from his own stocks, had not been conducted by the Area Supervisor with the assistance of the officers of the Measurement Units Standards and Service Department (MUSSD). According to the audit test check conducted in this regard, it was observed that the actual calibrations of those pumps were not within the standard level. Following further observations are made.

- Those two pumps had been used only for bulk issues.

- The responsibility of the Area Supervisor to check the calibration of those dispensing pumps had been ignored.

- Area Managers and the Marketing Manager had not taken remedial actions to rectify the detected issues relating to the improper bulk sales carried out by dealers from their own fuel stocks.

(vi) According to the instructions given by the above mention letter No. MKT/13/35 dated 15 August 2013, the said dealer should have been paid only discounts for bulk sales. However, the Corporation had paid through put charges and slab charges (transport charges) to the CPSTL for storage and distribution facility, in addition to the payment of discounts to the dealer. According to the audit test check on bulk sales during the period from February to April 2015, it was observed that the Corporation had paid a sum of Rs. 12,012,134 to the CPSTL with regard to the bulk sales made by the above mentioned dealer in addition to the dealer discounts paid to him. Details are as follows.

Description	Amount
	Rs.
(i) Throughput Charges	8,678,928
(ii) Slab Charges (Terminal to Depot)	830,519
(iii) Transport – (Galle to Dealer)	2,502,687
Total	**12,012,134**

According to the above inappropriate practices, the total estimated loss incurred by the Corporation during the year 2015, was approximately (12,012,134 X 4) Rs. 48,048,536.

(vii) The following deficiencies were observed due to lack of proper procedure to select dealers for bulk sales and weaknesses in monitoring system of the process of bulk sales.

- Instead of distribution of fuel directly to the consumers only from the Sapugaskanda Terminal, dealers had used to distribute fuel to consumers in bulk quantity from their own stocks inappropriately.

- It was revealed that when transporting fuel by dealers from their own stocks to consumers, the bowsers used for that purpose had not been sealed. Accordingly, it was observed that the Corporation had not established a proper procedure to ensure the quality and the quantity of fuel distributed by dealers on the bulk sales basis.

- Risk of unloading of contaminated fuel to consumers due to lack of proper procedure for the bulk sales carried out by the dealers.

- Obtaining of unauthorized charges from consumers. For example, instances of charging of higher prices than the retail prices of fuel from the consumers on bulk sales were observed.

- Incurring heavy losses on bulk sales by the Corporation due to needless payments of through put charges and slab charges on bulk sales.

- Some dealers had carried out bulk sales without any permission of the Corporation and obtained unauthorized gains. According to the audit test check, it was observed that some dealers had distributed fuel on bulk sales basis from their own fuel stocks without any permission and earned unauthorized gains. For instance,

- A dealer had sold 54,800 liters of diesel on the basis of bulk sales in September 2015 to Marine Services without any permission. Accordingly, the Corporation had incurred an estimated loss of Rs.136,285 for the month of September 2015.

- That dealer had sold out 13,200 liters of diesel on bulk sales basis without any permission, and accordingly the Corporation had incurred an estimate loss of Rs. 32,828 in two instances as revealed in the audit.

(viii) The Area Managers and Area Supervisors were responsible for maintaining sufficient fuel stocks at each filling station and should aware of the policies of CEYPETCO that governed retail network and distribution of bulk products with the information of trip times assigned to tank trucks, duration of unloading, payment of transport for hired tank trucks etc. However, according to the above audit test check, it was observed that the Area Managers and the Area Supervisors had neglected their responsibilities relating to the following matters.

- Complying with the policies of CEYPETCO relating to the dealers' bulk sales of fuel.

- Taking required actions to prevent unauthorized bulk sales from the dealers' fuel stocks.

- Providing accurate and timely information to the Corporation with regard to such irregular activities of dealers.

(ix) Due to weaknesses in monitoring and supervision on the operations of filling stations, instances of improper usage of fuel pumps by dealers were observed. Some of such instances are as follows.

- According to the audit test conducted on a retail outlet in Galle, on 01 October 2015, following deficiencies were observed.

    - Main board seals of the dispensing pumps number 1 & 2 had been removed by the dealer for repair without informing to the Area Supervisor and the Area Manager, and the Area Supervisor had not aware about that. However, it was observed that without the main board seals, those pumps had been used for issuing fuel.

    - A main board seals of the diesel pump number 3 had been removed for repairing purposes and the dealer had informed to the Area Supervisor in this regard. However, the Area Supervisor had not recorded it in the complaints book at the regional office. Further, that pump had been used for issuing diesel without the main board seal.

- According to the audit test check on a retail outlet on 02 October 2015, the dispensing pump number 03 was not in working condition due to some faults. Even though, the dealer had informed to the Area Supervisor regarding that fault, the Area Supervisor had not taken any action to rectify the matter.

(c) Identified Losses

The following observations are made.

(i) According to the information made available, the Corporation had incurred the following losses caused by damages due to improper handling of lubricant containers and stocks. However, actions as per the Financial Regulations (FR) 103 and 104 had not been taken by the management with regard to those damages.

Year	**Amount of Damage**	**Reasons for Damage and Actions taken by the Management**
	Rs	
2012	8,670,455	Not made available
2013	Not available	-
2014	14,822,315	Not made available
2015	16,759,825	Not made available

(ii) The Corporation had incurred an abnormal loss amounting to Rs. 70.5 million from the following three petroleum products produced in the refinery process during the year 2015. Details are as follows.

Product	**Allowable Operation Loss (0.5%)**	**Actual Out-turn Loss As per Cost Sheets**	**Abnormal Loss Exceeding the Allowable Loss**
	(Rs.)	**(Rs.)**	**(Rs.)**
Lanka Furnace Oil (800)	73,224,814	116,508,897	43,284,083
Lanka Furnace Oil (1500)	46,525,010	71,713,240	25,188,230
Special Boiling Point (S.B.P.)	778,404	2,852,103	2,073,699
Total	**120,528,228**	**191,074,240**	**70,546,012**

4.4 Assets Management

The following assets had been lying idle since the acquisition.

(a) Halgaha Kumbura Land at Wanathamulla - This land had been acquired for Rs.10.6 million for the purpose of LP Gas Project and a Playground. However, this land had not been utilised for the purpose and it had been occupied by more than 700 squatters.

(b) Mahena Land – According to the correspondence made available, the Corporation had acquired that land for a sum of Rs. 0.625 million, and it had not been accounted for. However, that land had been utilized by the previous owner even after the acquisition in 1986.

(c) Investments - The caring value of the investment made in quoted and unquoted shares of four companies as at 31 December 2015 was Rs. 34.63 million. However, no dividend since longer period had been received to the Corporation thereon.

4.5 Resources Released to Other Institutions

The following observations are made.

(a) In contrary to the instructions of the Circulars, particularly, the Public Enterprises Circular No. PED/12 of 02 June 2003 on Public Enterprises Guidelines for Good Governance, the Letters of No. CSA/P1/40 of 04 January 2006 and the No. CS/1/17/1 of 14 May 2010 issued by His Excellency the President, and the Public Enterprises Circular No. 21 of 08 January 2004, the Corporation had released the following resources to other institutions and incurred a considerable amount of money on payment of remuneration and other allowances on behalf of released employees and payment of fuel and maintenance expenses for released vehicles. Details are shown below.

Type of Resource Released	2015		2014		2013	
	Number	Cost Incurred by the Corporation	Number	Cost Incurred by the Corporation	Number	Cost Incurred by the Corporation
		Rs.		Rs.		Rs.
Human Resources	11	3,452,737	56	46,261,907	44	41,980,142
Vehicles	03	641,375	07	7,808,961	07	4,461,920
Total		**4,094,112**		**54,070,868**		**46,442,062**

(b) Further, 02 officer had been released by the Corporation on no-pay basis since 2014.

(c) Moreover, according to the information made available, it was revealed that the Corporation had continued the same practice during the year 2016 as well.

(d) Accordingly, it was observed that the management of the Corporation had not taken remedial actions to rectify that situation and to take disciplinary actions against the officers who were responsible for these mismanagements.

4.6 Human Resources Management

The following observations are made in this connection.

(a) Out of the total approved cadre of 3,284 for the year under review, 705 posts or 21 per cent were in vacant as at 31 December 2015, and out of that, 120 posts or 27 per cent were in the senior staff level including the Manager Internal Audit, Manager Agro Chemicals, etc. Accordingly, running the entity's operations efficiently having such a huge number of vacancies was questionable in audit.

(b) According to the approved cadre of the Corporation, the post of the Manager (Secretariat/ Secretory to Board) has been in vacant since 2012.

(c) A Manual of Procedures on Human Resource Management had not been prepared in accordance with Section 9.14 of the Public Enterprises Circular No. PED 12 of 2 June 2003.

(d) The Corporation had not maintained proper succession plan to mitigate the risk of filling vacancies in the posts of the senior management level when they get retired from the service in terms of provisions in the above mentioned Circulars. However, it was revealed that the Corporation had extended the service of retired officers on contract basis due to lack of succession plan.

5 Accountability and Good Governance

5.1 Corporate Plan and Action Plan

Even though a Corporate Plan for the period 2014 to 2018 and an Action Plan for the year 2015 had been prepared, the Corporation had failed to achieve the following major targets during the year 2015.

(a) Construction of 2nd bitumen tank.

(b) Installation of charger points (recharging facilities) for new Electric/Hydrogen Cells Vehicles especially at 25 numbers new CEYPETCO dealers owned category outlets.

(c) Construction of a lubricant blending (BOT model) plant at Muthurajawela with Hyrax Oil. (It was revealed that the Corporation had entered into an agreement with the M/s. Hyrax Co. of Malaysia in this regard on 06 May 2016.

(d) Construction of Fuel Hydrant system under Bandaranayake International Airport (BIA). (Phase II stage 2 development and upgrading the existing Aviation Refueling Terminal facilities of BIA).

5.2 Internal Audit

The internal audit function should be properly resourced with competent and capable persons and headed by a senior level officer (DGM) who is responsible for reporting the result of the internal audit works to the Audit Committee to ensure the independence of the Head of Internal Audit and internal audit department from the Finance Director and the Chief Executive Officer. Even though, the internal audit functions are required to be strengthened to review all areas, including examining, evaluating and monitoring the adequacy and effectiveness of internal control of the Corporation, it was observed that the internal audit functions had been deteriorated by the Corporation as follows.

(a) Out of the total approved cadre of 42 posts of the Internal Audit Division, 15 posts or 36 per cent were in vacant as at 31 December 2015, and out of which, 7 posts were in the senior staff level.

(b) According to the Organization Chart of the Corporation, the Chief Internal Auditor is directly responsible to the Managing Director of the Corporation.

(c) The Chief Internal Auditor had been acting in the post of Deputy General Manager (Finance) in full time since mid of 2011 due to the former Deputy General Manager (Finance) has been sent on compulsory leave since 2008 subject to the decision of a disciplinary inquiry which had been held regarding the Hedging transactions. Further, it was revealed that the former Deputy General Manager (Finance) has been dismissed with effect from 01 August 2016.

(d) Despite of the vacancies in the Internal Audit Division, pre-audit activities had been initiated by the Corporation. Accordingly, it was revealed that the formal internal audit functions had been deteriorated as a result of engaging the existing internal audit officers for pre-audit activities in full time at present.

5.3 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.

Major Areas	Observations
(a) Personnel Administration	The Managing Director is the Chief Executive Officer (CEO) of the Corporation and the Chairman and CEO is the same person. Even though the Committee on Public Enterprises (COPE) held on 2016 had directed to appoint two persons for those posts, necessary actions had not yet been taken by the Ministry of Petroleum Resources Development to do so. Failure to get the approval for the Scheme of Recruitment (SOR).
(b) Financial Control	Utilisation of funds for the execution of the main objectives of the Corporation.
(c) Trade and Other Receivables	There were weaknesses in controls over the collection of dues in time and mitigation of the default risk.
(d) Accounting and Financial Management	Utilization of funds for the execution of the main objectives of the Corporation had not been carried out adequately.
(e) Procurement	Complying with the provisions of the Government Procurement Guidelines
(f) Utilization of Resources	Complying with the Circular instructions in deploying the resources.