

State Timber Corporation - 2015

The audit of financial statements of the State Timber Corporation 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 any direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section, 29 of the State Industrial Corporations Act No.49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2) (c) of the Finance Act appear in this report. A detailed Report in terms of Section 13(7)(a) of the Finance Act, will be furnished to the Chairman of the Corporation in due course.

1.2 Managements Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Accounting Standards 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 judgment, including the assessment of risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

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

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Qualified Opinion

In my opinion except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Timber Corporation as at 31 December 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 Sri Lanka Accounting Standards

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

(a) Sri Lanka Accounting Standard -01

Even though surpluses or deficiencies occurred in the provisions made for the pensions gratuity commitments should be disclosed separately in the comprehensive income statement, the Corporation had not identified the surpluses or deficiencies disclosed in the comprehensive income statement.

(b) Sri Lanka Accounting Standard-16

(i) Even though the useful life of property, plant and equipment reviewed at the end of the year of accounts and the provisions for depreciations should be revised accordingly, assets costing Rs.879,187,990 had been fully depreciated and stated the value of each item at Rs.5.00 . Action had not been taken either to revise the rate of depreciation if they are further utilized or to take suitable action if they are not utilized to show their fair value or to disclose in the accounts.

(ii) Even though walls, gates, boundary fence valued at Rs.25,410,700 with a defined useful life included in the lands valued at Rs.84,467,845 had been shown and being brought forwarded at cost since the year 1968. Depreciation had not been made as those assets were shown under lands. Action had not been taken to revalue the assets to show its fair value , though the current market prizes of the lands which had been accounted from a long period at cost had considerably changed .

(c) Sri Lanka Accounting Standard-37

When the value of loss can be identified, provision for contingent liabilities should be made in terms of the standard. Nevertheless, no provision had been made for the arrears of salaries amounting to Rs.1,957,174 which had to be paid to an interdicted officer who had been acquitted from his charges.

(d) Sri Lanka Accounting Standard -40

A part of the Head Office building of the Corporation the value of which had been stated as Rs.5 had been rented out to 2 Government institutions and an income of Rs.14,714,790 had been earned. However, the value of this building had not been brought to account after being revalued under the investment assets .

2.2.3 Unexplained Differences -----

Differences ranging from Rs.21,774 to Rs.878,986,690 were observed in the comparison of 4 items of taxes and the stampage value payable included in the financial statements with tax returns. and the registers of the Department of Forest Conservations .

2.3 Accounts Receivable and Payable -----

The following observations are made.

- (a) Action had not been taken to recover the dues amounting to Rs.11,873,954 recoverable from a private company included in the trade and other balance receivable as at 31 December in the year under review from more than 30 years and the deposits totalling Rs.1,132,198 over 5 years receivable from Government and Semi-Government Institutions, loan balances totalling Rs.13,018,508 over 2 years even up to May 2016, the date of audit.
- (b) Recovery of a sum of Rs.69,249 recoverable from 06 officers who had obtained furniture under the “Prasada Abhimani” loan scheme had remained idle from the year 2011 and action had not been taken even up to May 2016 to recover these money from the relevant officers or the guarantors.
- (c) It was observed that the credit control was at a weak level due to the reasons such as to write off a large values as bad debts during the previous several years, non - recovery of debtor balances in an updated manner, action not taken to recover the debts by imposing a surcharge on them on delayed payments .
- (d) Advances amounting to Rs.95,000 and Rs.13,822,462 paid in the years 2011 and 2014 respectively to obtain goods and services and the contractors of the work sites of the Corporation had not been settled even in the year under review.
- (e) A sum of Rs.13,223,972 had not been recovered from the year 2014 as the electricity, water and buildings rent from the Department of Forest Conservation.

- (f) The amount payable as stumpage to the Department of Conservation of Forests by the Regional Offices of the Corporation from the year 2010 to the year under review amounted to Rs.97,540,310.
- (g) Action had not been taken to settle or bring it into revenue the retention money of the contractors and security deposits remained for a period more than 2 years totalling Rs.4,913,467 and Gang nail deposits of Rs.484,450 remained for a period of more than one year .

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

 The following instances of non-compliance with laws, rules, regulations and management decisions were observed.

Reference to Laws, Rules, Regulations, etc.	Non- compliance
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(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka (i) Financial Regulations 104(3) and 104(4)	Even though committees had been appointed to submit preliminary reports and full reports in terms of Financial Regulations in respect of 14 vehicle accidents occurred from the year 2013 up to the end of the year under review, the number of accidents for which preliminary reports were not submitted was 07.
(ii) Financial Regulation 571(2)	Even though the security deposits made by contractors and refundable tender deposits made by the suppliers should be refunded after the completion of the relevant task, action had not been taken accordingly. There were deposits amounting to Rs.2,082,701 and tender deposits amounting to Rs.20,750 lapsed for over two years.
(b) Procurement Guidelines (i) Section 2.8.4	In purchasing technical equipment with high values ,an outside person who has the expertise knowledge in the subject of procurement should be appointed to the Technical Evaluation Committee by the line Ministry or procurement entity. Nevertheless, the Corporation had not appointed such a person to the committee.
(ii) Section 4.2.3	After receiving the Technical Evaluation Committee recommendations , the goods should be purchased within 4 weeks. Contrary to that, purchase had been made in two occasions after a delay of 07 months since the receiving of the Technical Evaluation Committee report.

- (c) Sections 8.3.9 and 9.4 of Public Enterprises Circular No.PED/12 of 02 June 2003. Three employees had been released from the service of the Corporation for the service of a Company contrary to the provisions of the Circular.
- (d) Section 5.2(c) of the Public Finance Circular No.01/2014 dated 17 February 2014 A Human Resources Development Plan had not been included in the Action Plan. Further, development activities made on behalf of the Government and the development activities implemented as commercial purposes should be identified separately in terms of the said Circular but it had not been so identified.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result for the year under review amounted to a surplus of Rs.369,890,477 as compared with the corresponding surplus of Rs.205,997,864 for the preceding year. Accordingly, an increase of Rs.163,892,613 in the financial results as compared with that of the preceding year was observed. Even though, the tax expenses had increased by Rs.152,584,280, increase of the gross income by Rs.303,664,054 had been the main reasons for the increase in the financial result.

In the analysis of the financial results in the year under review and 4 preceding years, the financial result had increased continuously from the year 2012 to the year under review. The contribution had decreased in the year 2013 as compared with the years 2011 and 2012 in considering the employee emoluments ,taxes and depreciation on non-current assets. However, it had increased again in the years 2014 and 2015. The increase of the contribution in the year under review as compared with the preceding year was 23 per cent.

3.2 Analytical Financial Review.

According to the information made available to audit, significant financial information for the year under review and the preceding year is given as follows.

Item	Year Under Review	Preceding Year	Percentage of difference increase/(decrease) as compared with the preceding year.
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	Rs.	Rs.	Percentage
Turnover	3,836,191,364	3,473,847,448	10.43
Cost of Sales	2,079,076,399	2,020,396,537	2.90
Gross Profit	1,757,114,965	1,453,450,911	20.89
Administrative Expenses	706,105,228	740,913,217	(4.70)
Profit Before-Tax	768,699,335	427,222,442	79.93

Taxes paid to the Treasury	50,000,000	25,000,000	100
Profit after Tax	718,699,335	402,222,442	78.68
Income Taxes	348,808,858	196,224,578	77.76
Total Comprehensive Income	390,148,289	205,997,864	89.39
Stock Turnover Ratio	1.96	1.96	
Stock Turnover Period(Days)	186	185	

- (a) The increase of the gross profit ratio in the year under review as compared with the preceding year is 20.89 per cent. Even though, the cost of sales of the year under review had increased by 2.9 per cent as compared with the preceding year, increase of income by 10.43 per cent had been the reason for this improvement.
- (b) The increase of the net profit in the year under review as compared with the preceding year was 79.93 per cent. Decrease of administration expenditure by 5 per cent and increase of operating income by 21.85 had been caused to this increase. Eighteen per cent of the other operating income had been the over provisions of pensions gratuity whereas 47 per cent of the operating income had been the over provisions of doubtful debts and stock losses . Therefore, the increase of this net profit was not generated from operating activities and it was an increase of the nominal value other than the increase of financial value . Therefore, a significant increase of the operating efficiency of the Corporation was not observed.
- (c) It was observed that the manufactured goods remained in stores during a long period as the stock turnover ratio and stock turnover period being 1.96 and 186 days. respectively due to the closing stock had been maintained consistently by the Corporation. It indicated that the Corporation had not paid attention on marketing strategies to turn the trading stock expeditiously into the turnover.

3.3 Legal Cases Initiated Against the Corporation or by the Corporation

Twenty four legal cases comprising of 02 labour office cases, 02 Arbitration cases, 03 Labour Tribunal cases, 03 Magistrate Court cases ,06 District Court cases, 03 High Court cases, 03 Appeal Court cases and 02 Supreme Court cases had been instituted against the Corporation by end of the year under review. A case instituted before the Magistrate Court by the Corporation was being heard by the end of the year under review .

4. Operating Review

4.1 Performance

The following observations are made.

- (a) The State Timber Corporation was established with the following objectives defined by the Gazette notifications No.14796 of 04 April 1968 , No.178/10 of 05 February 1982, and No.1190/7 of 26 June 2001 Under the State Industrial Corporation's Act, No.49 of 1957 .
- (i) Extraction of Timber from State Forests, conversion of such timber into sawn

timber and finished products, sale of logs, sawn timber and finished products and construction of forest roads required for the above purpose

- (ii) Acquisition, construction and operation of logging units, sawmills, impregnation and preservation plants, seasoning and drying kilns and other necessary equipment and installations.
- (iii) Operation of timber and firewood sales depots, manufacture and marketing of any by-products from timber, import of timber.
- (iv) Afforestation, reforestation and scientific management of forests and forest plantations .
- (v) Import of agricultural production and cane.
- (vi) Export of timber related finished and semi-finished products and purchase of timber from private lands.
- (vii) Processing of forest related products
- (viii) Identification and certification of local and imported timber species.
- (ix) Conduct training programmes on timber industry related subjects and issue certificates and undertake environmental awareness programmes.
- (x) Planning and making investments so as to optimize the return from the lands and buildings owned by the Corporation.

Action had not been taken to achieve the objectives of import of agricultural production and cane among the objectives stated above.

(b) Sales Turnover

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- (i) An increase of Rs.396,150,785 or 10.41 in total sales turnover was shown in the year under review as compared with the preceding year and 59 per cent from timber logs, 4.4 per cent from sawn timber, 4.05 per cent from sleepers 5.7 per cent from electricity transmission polls and 6.8 per cent from sale of furniture had been contributed to the sales turnover in the year under review. An increase of 27 per cent from timber logs had existed as compared with the preceding year and the increase of normal price of teak had affected in this connection.
 - (ii) It was shown that the contribution of sales income decreased from sleepers by 55.19 per cent and electricity transmission polls by 30.66 in the year under review as compared with the preceding year. A deterioration in the life cycle of the production of sleepers and electricity transmission polls had been shown in considering the contributions of the preceding five years. The government monopoly in respect of these productions had existed to the State Timber Corporation up to now and the use of these products are being gradually minimized and a threat of losing the sales income was shown.

(c) Sale of Furniture

Even though a sales growth rate of 20 per cent had shown in the year 2014 as compared with the year 2013, there was a decrease up to 13 per cent in the sales growth rate in the year 2015 as compared with the year 2014. Even though the sale of furniture could be identified as one of the main income of the State Timber Corporation, the sale of furniture represented as low value as 6 per cent from the total sales turnover of the year under review. Even though, there was a monopoly existed in obtaining government timber, failure to offer competent productions to the market with modern technology, failure to follow a competitive and flexible pricing policy, failure to carry out a market survey, showrooms not extended as to cover the whole island, failure to focus on new marketing strategies and non-pursuing market opportunities are mainly attributed on this decrease.

According to the Corporate Plan prepared for the period from 2013 to 2017, the observations in relation to the achievement of the targets included in the Action Plan of the year 2015 are given below.

- (i) No any action whatsoever had been taken to fulfill the following activities.
- To conduct 03 advisory services programmes to make attitudinal change in the employees.
 - To provide necessary facilities for the employees for the favorable work environment .(Project Proposals)
 - To conduct a programme to develop the skills and capacity building of the employees.
 - To create a network control system of sawn timber .
 - To establish and maintain a separate server exterior to the Corporation's premises.
 - To create a network stock control system for the factories at Kaldemulla, Boralanda, Keppetipola and Boossa.
 - To create a network documentation measurement system.
 - To create a network stock control system for the stores at the Head Office.
 - To increase the production by 2 per cent as compared with the whole existing productions.
- (iii) Out of the objectives to be achieved in the year 2015, 68 percent of the target of obtaining matured teak trees as discussed with the Department of Wildlife, 88 per cent of the target of import the high quality sawn timber and 50 per cent of the target of creating a network statistical information system had not been fulfilled.

4.2 Transactions of Contentious Nature

Twelve constructions works such as official quarters, timber stores and circuit bungalows by spending Rs.49,689,568 in the lands which had no legal ownership to the State Timber Corporation had been carried out.

4.3 Idle and Underutilized Assets

The following observations are made.

- (a) The employees hostel at Kandapola which was constructed by spending a cost of Rs.12,796,781 had been used by an officer contrary to the objective of the construction. Although 12 beds and 14 mattresses had been purchased and paid a sum of Rs.491,235 for the use of the hostel, they had remained idle without being used. Fans had also been fixed by spending Rs.105,000 without considering the weather condition of the area.
- (b) Two machines which were not used and had not been accounted under the fixed assets, handed over to the Corporation from the River Valleys Development Board had remained at the Ampara saw mill and action had not been taken to repair and use or to dispose them.

4.4 Identified Losses

The following observations are made.

- (a) Hundred Carbide plates out of 256 plates purchased by spending a sum of Rs.698,124 in the year 2012 had been returned to the company from which they had been purchased as they were not in the prescribed standard and 78 plates out of them, valued at Rs.149,078 had not been received to the Corporation even by 30 April 2016.
- (b) A surcharge of Rs.44,889 as encroachment charges had been paid to the Nuwaraeliya Municipal Council as construction of Nuwaraeliya employees quarters had been carried out without getting approved the building plans .
- (c) Surcharge of Rs.54,570 had been paid by the Corporation as the gratuity had not been paid to a female officer on time.

4.5 Deficiencies in Contract Administration

The following observations are made.

(a) Construction of Dela Timber Stores

- (i) Even though goods valued at Rs.194,100 and Rs.33,120 had been purchased for the construction of the water tank and concreting the access road to the official quarters respectively in the year under review , those activities had not been done even by 30 April 2016.
- (ii) It had been decided to supply the raw materials by the Corporation in the construction of employees quarters and boundary wall and to obtain labour by Measure and Pay basis . However, it was not revealed whether the raw materials purchased for the constructions exactly obtained only for the required quantity as the estimates for materials and labour had not been prepared separately.

- (iii) An over estimate of Rs.696,863 and an under estimate of Rs.72,031 had been prepared due to non- preparation of accurate estimates for the construction of employee quarters.

(b) Construction of Ampara Employees Quarters (A and B)

The following observations are made at the physical verification of the employee quarters which the construction cost which was of Rs.33,880,099.

As a result of weak designing and supervision of the consultancy services firm the construction faults such as the door of the outdoor kitchen fixed so as to open it to outside and fixed with iron tee hinges and therefore the houses were unprotected, a methodology had not been arranged to flow the water remained in the balconies to outside, stagnation of water due to the drainage system not constructed with a proper slope ,the cover of the drainage system had fit in an unprotected manner, interlocks fixed in front of the complex had not been made in a proper standard, the walls of the drainage system of the backyard were in an upper position from the ground level were observed.

(c) Construction of the Ground Floor and the First Floor of the Employee Quarters at Nuwaraeliya

The following observations are made.

- (i) Despite the consultancy firm had stated that, it had not been satisfied the adequate working capital requirement, bank facilities and the similar work done previously on contractor selected, the contract work had been granted to the same contractor without being paying attention on that matter by the Procurement Committee in awarding of the contract.
- (ii) A sum of Rs.237,808 had been paid, based on the Engineering Estimate in making payment to the consultancy institute.

(d) Construction of the Second Floor of the Employee Quarters at Nuwaraeliya belonging to the State Timber Corporation

The ceiling of the hostel had been completed by using a plastic material by spending Rs.513,920 for 128.48 square meters, though it could have been completed with using Corporation's timber. Constructions had also been carried out by using aluminium and iron bars in many places where timber could be used.

- (e) The construction of the side wall of the Nuwaraeliya employee quarters had been fulfilled by a private institution at Rs.682,734 without calling for tenders .

4.6 Personnel Administration

Observations on the approved and actual cadre of the Corporation by 31 December 2015 are given below.

- (a) The approved cadre of the middle level management was 64 and the number in service was 62. Even though 02 vacancies existed as a whole, excess of 7 Deputy Managers had been covered by the vacancies of other officers.
- (b) Out of the middle management level posts ,the number of excess employees of Regional Manager, Deputy Manager (Finance), (Legal and Administration) Engineer and system analyst was 07 , the number of excess cadre was 45 than the approved cadre in the posts of Cost Officer, Engineering Assistant(Civil), Investigation Officer belonging to the lower management and the number of excess cadre in the posts of management assistants (semi technical) was 59.
- (c) In considering the approved cadre and the actual cadre of the Corporation, the cadre approved to achieve the objectives and strategies of the Corporation had not been recruited.
- (d) Despite recommendations had been received after conducting a preliminary inquiry in respect of a misconduct of an officer that a sum of Rs.64,329 should be recovered from the officer and transfer him from the present work place , this officer had been called for an interview and promoted to the post of Manager (Show rooms) and he had been appointed to his former work place.

5. Accountability and Good Governance

5.1 Procurement Plan

The following observations are made.

- (a) Twenty six goods of capital nature valued at Rs.979,673 not included in the Procurement Plan and 12 items valued at Rs.1,489,110 exceeding the planned quantity had been purchased.
- (b) Even though, it had been planned to purchase 522 capital items in the year under review, only 92 items had been purchased.
- (c) Even though, a sum of Rs.990,000 and Rs.2,161,000 had been budgeted to purchase Dot matrix printer and a Laser printer respectively those values as per procurement plan were Rs.1,890,000 and Rs.1,286,000 respectively. As such difference between the budget and the procurement plan were observed.
- (d) Even though a Procurement Plan had been prepared, it had not been prepared in a realistic manner .As such the procurement plan had not been made use of as an effective instrument of management control.

5.2 Budgetary Control

Variances ranging from 20 per cent to 738 per cent were observed between the budget and actual income and expenditure, thus indicating that the budget had not been made use of as an effective instrument of management control.

5.3 The Adverse Effect Caused to the Environment due to the Activities of the Corporation

The following observations are made.

- (a) The number of work sites fully fallen for the activities of the Corporation in the year under review was 605.8 hectares (1505.0 acres) and the contribution given from the year 2013 for the re-forestation was 68 hectares (169 acres). The contribution given for the re-forestation was at a minimum level as compared with the fully fallings. Further, the activities of the Corporation depend on trees whereas there had been often damages caused to the animals and destroyed the premature trees when attenuating forest plantations for manufacturing.
- (b) The products of the Corporation consisted of timber logs, sawn timber, sleepers, electricity transmission poles, tance poles, elephant poles and furniture. Sleepers to the Sri Lanka Railways, transmission poles to the Ceylon Electricity Board, elephant poles for the Department of Wild Life are supplied under concessionary credit periods. In the supply of furniture, a loan scheme of "Prasada Abhimanee" is implemented which targeted only Government Servants but not targeted the private sector employees. However, it could not be satisfied for not to supply of furniture to the general public at a concessionary method and very high furniture prices as compared with the competitors.

5.4 Unresolved Audit Paragraphs

Even though the Chairman of the Corporation had informed on 28 June 2013 that further action would be taken against the contractor and the Corporation officers in respect of unauthorized felling in the Bagawanthalawa Chapelton commercial level plot of land, no action whatsoever had been taken in that connection even by 20 May 2016.

6. Systems and Controls

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

Areas of Systems and Controls

Observations

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| (a) Debtors and Creditors Control | Action not taken to recover the loan balances recoverable within the credit period, action not taken to pay the royalty to be paid to the external parties and action not taken to refund the various deposits which had elapsed the period. |
| (b) Budgetary Control | The budget had not been made use of as an effective instrument of management control of the Corporation and non- preparation of accurate estimates. |

- (c) Fixed Assets Control The ownership of the fixed assets had not been established and assets not utilized in a proper manner.
- (d) Procurement and Contract Administration Action not taken according to the instructions of the Procurement Guidelines, specific services had not been obtained properly from the Consultancy services in contract administration and contracts had not been carried out properly by following suitable actions.
- (e) Personnel Administration Recruitments and Promotions had not been carried out in terms of institutional rules and regulations.