Lanka Coal Company (Private) Limited – 2016

The audit of the financial statements of the Lanka Coal Company (Private) Limited("the company") for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka. My comments and observations on the operations of the company which I consider should be furnished to the parliament in terms of Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka appear in this report.

1.2 Board's Responsibility for the Financial Statements
--

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

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

1.4 Basis for Qualified Opinion

(a) The tax receivables in relation to Value Added Tax (VAT), Economic Service Charges (ESC) and Withholding Tax amounting to Rs.26,506,918,Rs. 894,150 and Rs.77,718 respectively and tax payables in relation to Income Tax, Nation Building Tax (NBT) and VAT amounting to Rs.11,703,151,Rs.3,371,326 and Rs.12,758,801 respectively shown under Notes 10 and 14 to the financial statements could not be satisfactorily verified due to non-availability of sufficient documentary evidence such as tax computation details and tax returns etc.

Similarly, income tax liabilities shown as opening balance of the year under review, under Note - 17 to the financial statements aggregating Rs. 65,474,540 were not agreed with the balance shown in the record of the Department of Inland Revenue. Further, the reliability and accuracy of that liability could not be scrutinized in audit due to non-availability of information such as computation details and tax returns etc.

(b) The amount payable to the Ceylon Shipping Corporation Limited as at 31 December 2016 as per the financial statements of the Company was Rs.170,378,808 whereas according to the confirmation received from the Ceylon Shipping Corporation Limited it was shown as Rs.788,958,985. Hence, an un-reconciled difference of Rs.618, 580,177 was observed between those two records. Therefore, the accuracy of this balance could not be ascertained in audit.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in basis for qualified opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

According to the agreement entered into between the Ceylon Electricity Board (CEB) and the Company on 05 September 2013, the main function of the Company is procuring coal from international market (the CEB pays for Letters of Credit opens by the Company in its name) and selling them back to the CEB without keeping any profit margin. Further, the all the operating expenditure of the Company which remained after setting off to any other income earned by the Company (i.e. net overhead cost of the Company) will be met by the CEB. However, the Company had failed to recognize the sales revenue, cost of sales, and operating expenditure etc. arisen from its main function in the financial statements prepared for the year under review.

2.1.1 Report on Other Legal and Regulatory Requirements

As required by Section 163 (2) of the Companies Act No.07 of 2007, I state the followings:

(a) The basis of opinion and scope and limitations of the audit are as stated above.

(b) In my opinion :

- I have obtained all the information and explanations that were required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company,

- The financial statements of the Company comply with the requirements of Section 151 of the Companies Act No. 07 of 2007.

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

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

	Reference to Laws, Rules and Regulations etc.	Non-compliance
(a)	Public Enterprises Circulars No. PED 1/2015 dated 25 May 2015	Contrary to the Circular instructions, a sum of Rs.600,000 had been paid in excess for 3 officers of the company for the year 2016 as transport allowances.
(b)	Public Enterprises Circular No.PED4/2016(1),dated 19 October 2016 and No.PED1/2015(1) dated 27 October 2016	A vehicle had been obtained by the chairman under lease base and as per the provisions of the circular monthly rental of Rs.195,000 had been paid by the company. However contrary to the Circular instructions a driver from the drivers pool of the company had been attached to the General Manager who claims transport allowance for his private vehicle. In addition a sum of Rs.454,743 had been paid to the chairman as fuel allowance for the year under review and a sum of Rs. 51,000 had been reimbursed as expressway bills by the Company during the year under review.
(c)	Public Enterprises Circular No.PED /12 dated 02 June 2003	Although an approved medical scheme was not available in the company a sum of Rs.1,014,176 had been reimbursed to the staff as medical expenses during the year under review.

(d) Government Procurement Guidelines - 2006 NPA Circular No: (08)		
(i) Guide Line8.9.3	Although the procurement agreements exceeding the value of Rs.500 million, should be signed by the Secretary to the Line Ministry, Coal procurement agreements exceeding the said value had been signed by the chairman since the commence ment of the company.	
(ii) Guide Line 8.8	Even though the unsuccessful bidders should be informed of their shortcomings in brief with the overall objective of educating the bidders to submit more responsive and competitive bids in future, instructions of the Guidelines, had not been followed by the company in all procurements made by the company.	
(e) Inland Revenue Act No . 10 of 2006	(i)	PAYE tax relating to the allowances paid to the Board of Directors had not been deducted and returned to the Department of Inland Revenue.
	(ii)	PAYE tax relating to the year 2015/2016 had been deducted according to the rates applicable to the year 2014/2015.

3. Financial Review

3.1 Financial Result

According to the financial statements presented, the operations of the Company for the year ended 31 December 2016 had resulted neither pretax net profit nor net loss as per the preceding year, due to entering into an agreement with the Ceylon Electricity Board to reimburse the net overhead cost incurred by the Company since the previous year.

4. Operational Review

4.1 Performance

4.1.1 Planning

A Corporate Plan and Annual Action Plan had not been prepared by the Company according to the Public Enterprises Circular No.PED/12 dated 02 June 2003.

4.1.2 Operating and Review

The following observations are made.

(a) Even though the Cabinet of Ministers had granted approval for the establishment of the Lanka Coal Company for execution of the specified function of purchase of Coal required for the Coal Thermal Power Plants, it was observed that the Lanka Coal Company arrogated to itself certain functions assigned to other public institutions by Parliamentary Acts, in its objectives thus covering a scope much wider than the objectives of the establishment of the Company.

(b) According to the agreement entered into between the Company and CEB on 01 September 2015, CEB reimburses net overhead cost incurred by LCC. Therefore, annual profit or loss cannot be considered to measure the performance of the Company and Articles of Association of the Company enable to spread over numerous businesses. However, LCC had not expanded its business since incorporation.

4.2 Management Activities

The following observations are made.

(a) Accurate formulae in the bid documents pertaining to the price adjustments for coal quality had not been included in the coal supply agreement entered into between the Company and the Liberty Commodities (Private) Limited (LCL). As a result, the Company had made an overpayment of Rs.83, 520,248 and Rs.149, 673,070 in the years 2015 and 2016 respectively. However, M/s. Liberty Commodities Limited had already been suspended by the Special Standing Cabinet Appointed Procurement Committees (SSCAPC) and arbitration is in process to recover overdrawn money of Rs.233, 193,318 in relation to spot tenders and the legal fee incurred thereon during the year under review was Rs.8,138,790. Further it was observed that M/s. Liberty Commodities Limited, had been registered as a supplier of coal as an associated company of M/s. SIMEC Group Limited Further, one of the Directors of SIMEC was the Managing Director of M/s. Liberty Commodities Limited and he had kept the authorized signatory for the Spot Tenders and also official residences of LCL and SIMEC were in the same addresses in London, Dubai and Hong Kong. SIMEC had participated for relevant Spot Tenders and registration of a suspended supplier as a related party was questionable.

(b) According to the agreement entered into between the Company and CEB, expenses relating to procurement of coal only can be reimbursed. However, it was observed that the donations and sponsorships granted by the Company aggregating Rs.3, 270,000 had also been reimbursed relevant to the years 2015 and 2016.

(c) A sum of Rs.26,506,918 had been over paid in connection with VAT relating to importation of coal (59,019 Metric Tons) by Ceylon Shipping Corporation Limited (CSCL)

(d) Prices of the coal had been adjusted as per the quality analysis report issued at loading port instead of considering the quality analysis report issued at discharging port. However, most of time according to the discharge port quality analysis report, the quality of coal was lower than the quality of loading port quality analysis report. The penalty of Rs.184, 256,892 which could be chargeable in relation to Gross Calorific Value (GCV) and Ash content could not be recovered because prices had been adjusted as per the loading port quality analysis report.

(e) Although the Penalty over the grain size consist had been applied for earlier Term Tenders, it had been removed from Spot Tenders. As a result, the loss incurred in 2016 was Rs.461, 453,005.

4.3 Procurement Management

--

The following observations are made.

(a) Even though an order for 135,433 metric tons of deaf and thermal coal had been placed in two instances in the year 2011 from Ceylon Shipping Corporation Limited (CSCL) on a decision of the Board of Directors of the company, deviating the procurement process, 37,531 metric tons of deaf and thermal coal valued at Rs.539,192,078 had not been supplied to the CEB and the value of the unsupplied coal stock had not been reconciled with the CSCL even up to the date of this report.

(b) The company had obtained discharge port coal analysis reports from SGS Lanka (Private) Limited whereas, almost all instances, coal suppliers had also obtained load port quality analysis reports from subsidiaries of SGS. Conditions had not been included in agreements to prevent suppliers obtaining quality analysis reports from SGS group. Obtaining both reports from SGS group may affect to the independency of analyst and accuracy of the reports.

(c) Even though the Cabinet of Ministers had granted approval at the Meeting held on 22 July 2015 for awarding tenders subject to the condition that after each awarding the covering approval of the Cabinet of Ministers should be obtained at the earliest meeting. However, the covering approvals for the procurement had been obtained with delays from 04 months to 12 months.

4.4 Transactions in Contentious Nature

Although the scope, nature and responsibility of the General Manager CEB were expanded than the scope nature and responsibility of the managing Director of the company, according to a Board decision the salary of the managing Director of the company should be fixed on par with the General Manager’s salary of the CEB. Accordingly, he had been paid Rs.3, 472,560 for the year under review. However the accuracy of the decision taken by the board was questionable.

4.5 Human Resources Management

The following observations are made.

(a) Staff recruitments had been done without having formally approved Scheme of Recruitment (SOR).

(b) The employees of the Company had been paid in accordance with the salary scales of the Ceylon Electricity Board.

(c) As per the paragraph (b) of the Management Services Department Circular No.28 dated 10 April 2006, "Creation of posts under exceptional circumstances are essential, including effecting of recruitment to such posts, as well as filling of vacancies in critical positions in the exigencies of service, should be done only with the prior approval of the Department of Management Services (DMS) and also after ascertaining the availability of financial provision required therefor.

However, the Organizational Structure of the Company had been amended by the Board of Directors on 05 January 2017 creating seven new posts without obtaining approval from the Department of Management Services and three employees had been recrulted in 2016.

(d) Five employees had been recruited by the company during the year without following a proper recruitment and selection process by calling applications and holding interview.

(e) Job description had not been given by the company to some employees when recruiting and changing the duties and responsibilities.

5. Accountability and Good Governance

5.1 Procurement Plan

A Procurement Plan had not been prepared by the company for general requisition. However, tentative lay can schedules had been prepared based on the annual coal requirements of the Ceylon Electricity Board.

5.2 Internal Audit

An internal audit division had not been established and internal audit division of the Ministry had also not carried out an audit in the year 2016.

5.3 Audit Committee

Although the Company had formed the Audit Committee in 2015, no Audit Committee meetings had been held since then.

5.4 Social Responsibility

The bottom ash of Lakvijaya Power Plant was being dumped at the plant premises itself and had become threat to the environment. Therefore, the Company has commenced a project for managing ash disposal in an environmental friendly manner and the product was acceptable according to the tests carried out by Sri Lanka Standard Institution and Industrial Technology Institute. However, the project had been discontinued wasting the funds invested as well as letting the environmental issue to be continued.

5.5 Budgetary Control

(a) Significant variances ranging from 20 per cent to 1,596 per cent with respect to 25 items were observed between the budgeted and the actual figures, thus indicating that the budget had not been made use of as an effective instrument of management control.

(a) According to the Public Enterprises Circular No. PED/12 dated 02 June 2003, the Annual Budget should include a budgeted income and expenditure statement, a cash flow statement for the year a financial position at the end of the year, and a budgeted capital expenditure statement together with an Annual Action Plan. However, the Company had not complied with that requirement.

6. Systems and Controls

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

	Areas of Control	Observation
(a)	Payment	Vouchers not being certified properly before making payment and Payment vouchers had not been filled according to the order of cheque numbers.
(b)	Debtors /Creditors	No proper control over debtors and creditors.
(c)	Fixed Assets	(i) Fixed assets and inventory registers not being maintained. (ii) Fixed asset verifications not being carried out for the year under review. (iii) Identification labels not being used for fixed assets.
(d)	Segregation of Duties	Segregation of duties nod being done.
(e)	Cash Management	Remaining considerable amount of money in a dormant account.

(f)	Payroll Management	No proper control over the pay roll management.
(g)	Accounting	Proper accounting control method had not been followed in computer system.