

## **National Film Corporation of Sri Lanka – 2016**

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The audit of financial statements of the National Film Corporation of Sri Lanka 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 cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section 31(1) of the National Film Corporation of Sri Lanka Act, No.47 of 1971. 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.

### **1.2 Management's Responsibility for the Financial Statements**

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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**

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My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 financial statements. Subsections (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 Going Concern of the Corporation**

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The commission on distribution, which was one of the main sources of income, had been deprived of to the Corporation with the abolition in the year 1999 of the monopoly of distribution of films which existed with the National Film Corporation. As such, the General Treasury had made arrangements to grant provisions for employees' salaries since the year 2011 on the inadequacy of the Corporation's income in settling expenses.

Moreover, a situation of continuous loss was observed before receiving Treasury grants by the Corporation during the year under review and 4 preceding years and accordingly, it was observed that the going concern of the Corporation had been uncertain without the financial assistance of the Government.

#### **1.5 Basis for Qualified Opinion**

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

### **2. Financial Statements**

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#### **2.1 Qualified Opinion**

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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 National Film Corporation as at 31 December 2016 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**

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##### **2.2.1 Sri Lanka Accounting Standards**

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The following non-compliances were observed.

##### **(a) Sri Lanka Accounting Standard 7**

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In terms of paragraph 7 of the Standard, in accounting Treasury Bills and Bills Repurchasing, investments of three months or less should be indicated in the cash flow statement as a liquid asset equivalent to cash. However, the value of Treasury Bills to be matured within a period of three months amounting to Rs.9,612,350 and Bills Repurchasing amounting to Rs.103,361,405 had been shown under cash and cash equivalents.

**(b) Sri Lanka Accounting Standard 16**  
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- (i) In terms of paragraph 79(a) of the Standard, idle assets should be disclosed in statements of accounts. However, accounting and disclosures on assets with outdated technology belonging to the black and white and colour laboratories of the Kelaniya Studio of the Corporation, had not been carried out.
- (ii) Even though assets costing Rs.250,899,989 had been fully depreciated as the useful life of non-current assets had not been reviewed annually in terms of paragraph 79(b) of the Standard, they were being further used. Accordingly, action had not been taken to revise the estimated error in terms of Sri Lanka Accounting Standard 8.

**(c) Sri Lanka Accounting Standard 19**  
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Provision for post-employment benefits should be computed after carrying out an actuarial estimate in terms of paragraph 57 of the Standard. However, contrary to that, the Corporation had allocated a gratuity equal to half pay of the monthly salary to every employee for each year of service without identifying an accounting policy for allocating post-employment benefits.

**(d) Sri Lanka Accounting Standard 37**  
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Contributions for the Employees Trust Fund had been computed from January 2006 to December 2015 without considering the Cost of Living Allowance. As such, an outstanding sum of Rs.2,763,753 and a surcharge of Rs.1,381,876 had to be paid and the approval of the Board of Directors had been granted on 27 April 2017 therefor. Nevertheless, provisions had not been made in the accounts in terms of the Standard.

**(e) Sri Lanka Accounting Standard 38**  
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The software used for the post production activities in the Sarasavi Studio in Kelaniya had not been shown under intangible assets in the financial statements in terms of paragraph 119 of the Standard.

**(f) Sri Lanka Accounting Standard 40**  
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Even though investment assets should be recognized and disclosed in the financial statements in terms of paragraph 75 (c) of the Standard , appropriate disclosures had not been made on a building rented out to three institutions over a period of 15 years by the Corporation.

### **2.2.2 Accounting Policies**

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Even though it had been indicated in the financial statements that accounting property to the cost or the assessed value is the policy, the land bearing assessment number 224 located on Bauddhaloka Mawatha and the land of the Kelaniya Studio belonging to the Corporation had been valued for the last time in the year 2007. Accordingly, 10 years had lapsed as at the end of the year under review. However, action had not been taken to revalue these lands and to account the fair value.

### **2.2.3 Accounting Deficiencies**

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Fixed deposits valued at Rs.17,891,742 of the National Savings Bank which was a long term deposit, had been shown in the financial statements as a short term investment.

### **2.2.4 Unexplained Differences**

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The following observations are made.

- (a) A difference of Rs.13,495,075 was observed in the comparison of balances relating to 02 Items of Accounts included in the statement of financial position with the schedules/ ledger balances presented to Audit.
- (b) An unexplained difference of Rs.4,696,302 was observed in an inter departmental current account according to the books of the Corporation and the books of the Ridma Circuit.
- (c) Even though the balance of a bank current account had been indicated as Rs.10,607,968 in the statement of financial position as at 31 December of the year under review, that balance had been Rs.6,607,968 according to the Bank Reconciliation Statement, thus observing an unreconciled difference of Rs.4,000,000.

### **2.2.5 Accounts Receivable and Payable**

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The following observations are made.

- (a) No action had been taken to repay the monies recovered in excess from the debtors to the relevant persons or to take into the income or to take any other appropriate measure. As such, debtors credit balances of Rs.1,110,955 were being brought forward in accounts for over a period of 10 years.
- (b) Action had not been taken even by the date of this report to recover the film rental of Rs.12,343,433 recoverable from the year 2003 up to 31 May 2016 from the CineCity Cinema Hall in Maradana. Moreover, as the daily report had not been sent after 31 May 2016, the income from film rental could not be computed or disclosed by accounts.

- (c) Out of the amount received from the Treasury for voluntary retirement of employees, a remaining sum of Rs.5,000,000 had not been remitted to the Treasury.
- (d) Sums of Rs.7,604,528 from 163 cinema halls before assigning the activities of distributing films to private circuits in the year 2001 and a sum of Rs.74,412,984 from 186 cinema halls existed after assigning but closed down presently, had been recoverable as at the end of the year under review. Moreover, the outstanding amount recoverable from cinema halls belonging to circuits functioning at present amounted to Rs.149,054,764 and effective action had not been taken to recover those amounts in the year under review as well.
- (e) According to the financial statements presented, a loan totalling Rs.501,105,452 had to be recovered as production of cinema other loans and employees' advances. Out of those debtors, a 100 per cent provision for bad debts for the loan balance of Rs.129,103,283 not agreed and unrecoverable and a 5 per cent provision for the remaining debtors had been made. However, it was observed that the recovery of Rs.146,733,583 or 29 per cent out of the above debtors had been uncertain.

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

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 The following instances of non-compliance were observed in audit.

Reference to Laws, Rules, Regulations etc.	Non-compliances
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(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka	
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(i) Financial Regulation 381 (1)	Application to open official bank accounts should be made through the Chief Accounting Officer to the Treasury. Nevertheless, the Corporation had opened 08 bank current accounts without the approval of the General Treasury by 31 December 2016 and the balances of those bank accounts totalled Rs.36,705,863 as at that date.
(ii) Financial Regulation 454 (1)	A Main Inventory Book had not been kept in Form General 44 in respect of receipt and issue of inventoried articles and lists had not been maintained separately for each branch according to relevant Forms.
(iii) Financial Regulation 754	The Inventory Book had not been balanced at the end of each financial year and carried forward for the following financial year.

- (b) Decision No.අම/05/0741/041/012 dated 22 July 2015 of the Cabinet of Ministers. Non-ironic metals such as copper, brass, aluminum, lead etc. and the special type iron, cast iron and steel scraps discarded by Government institutions can be sold to the Industrial Development Board of Ceylon. Nevertheless, action had not been so taken in respect of iron scraps and script covers that had been stacked in an old building of the Sarasavi Studio.
- (c) (i) Sections 10(5) and 11 of the Finance Act of 1971 and Section 27 of the Film Corporation Act, No.47 of 1971 An income over expenditure amounting to Rs.111,502,287 from the year 2014 to the year 2016 had not been remitted to the Treasury and including that amount, sums of Rs.92,031,681 and Rs.173,871,346 had been invested in Treasury Bills and Treasury Bills Repurchasing respectively as at 31 December 2016 without the approval of the Minister of Finance and the relevant Minister.
- (ii) Section 7(2) of the Finance Act In computing the profit of the Corporation, the subsidies from the Government amounting to Rs.74,250,000 received in the year under review had not been taken into consideration and it had been shown in the comprehensive income statement after computing the profit/loss.
- (d) National Film Policy and Guidelines of 17 June 1999  
(i) Section 2.1 Even though a maximum credit of Rs.1 million should be provided for post-production activities such as printing and publicity of films by the People's Bank, contrary to that, a loan of Rs.20 million had been granted out of the Film Corporation Fund to the "Sarigama" film subject to the approval of the Board of Directors.
- (ii) Section 9 Even though a Film Preservation Unit should be established and managed by the Film Corporation, 273 old films belonging to the Film Corporation had been preserved in a repository in the Department of National Archives. However, no arrangement had been made to preserve 962 films screened from the year 1947 to the year 2016 and copies of new films.

- (e) Sections (a) and (c) of Schedule 111 of the Excise Notification No.902      Liquor permits should not be issued if a religious place or school is located within 500 metres and if the area of the place selling liquor is less than 500 square feet. However, recommendations had been issued for liquor permits in cinema halls without carrying out inspections thereon.
- (f) Section 61(2) (e) of the Film Corporation Act, No.47 of 1971      Instances were observed in which the rate that should be charged in the theatres for Three Dimensional (3D) films had been overcharged by Rs.100, exceeding the rate approved by the Corporation. Moreover, the Investigation Officers of the Corporation had not taken action to observe and correct such instances.

### **3. Financial Review**

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#### **3.1 Financial Results**

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The financial result of the Corporation for the year under review had been a loss of Rs.34,638,806 before receiving Treasury grants as compared with the corresponding loss of Rs.59,186,725 for the preceding year, thus indicating an improvement of Rs.24,547,919 in the financial result for the year under review as compared with the preceding year. Increase in other income by Rs.13,380,566 and decrease in provision for bad debts and gratuity by Rs.23,539,330 had mainly attributed to the above improvement.

An analysis of the financial results for the year under review and 04 preceding years revealed a continuous loss in the financial result before receiving Treasury grants and in the year 2012 it had been Rs.50,487,786 while as at the end of the year under review it had been Rs.34,638,806. However, in readjusting the employees' remuneration and depreciation for non-current assets to the financial result, the contribution of the Corporation which was Rs.31,192,547 in the year 2012 had increased to Rs.67,483,892 as at the end of the year under review.

### **4. Operating Review**

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#### **4.1 Performance**

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According to the National Film Corporation Act, No.47 of 1971, the Corporation had been established to achieve the objectives such as the production of films and import, distribution and supply of film formers, films, photographic equipment required for showing, export of films including the purchase of films and storing, establishment of studio and film halls for

film production, provision of facilities and assisting financially, pay tribute to film producers, awarding gifts and awards, organizing and conducting discussions and seminars, holding film festivals, publication of periodical magazines on films and conducting market researches on films inside and outside Sri Lanka. The following observations are made in respect of the achievement of those objectives.

- (a) Even though a sum of Rs.12 million had been allocated to co-produce 04 quality films per year as studio productions, as state sponsorship extended towards young film makers who had shown talents in television or any other relevant field for their first film production, that purpose had not been achieved.
- (b) Extending financial assistance in the production of films with the main objective of promoting the film industry is one of the objectives. However, no production loan whatsoever had been granted since the year 2012 and no action had been taken in achieving objectives such as conducting market research in respect of films inside and outside Sri Lanka.
- (c) Even though it had been planned to inspect even 2000 shows as a whole so that every cinema hall is subjected to inspection at least once a month, only 850 shows had been inspected during the year under review.
- (d) A sum of Rs.30 million had been allocated for purchase and installation of equipment for Acoustic treatment in the Vijaya Kumaranatunge Studio for mixing surround sound in films according to international standards and for purchase of equipment for recording songs and music in films. However, that purpose had not been fulfilled.
- (e) A specific unit had not been established in the Corporation for filing complains on the film industry and attention had not been paid on taking necessary and timely measures by recording the complains of viewers and film producers and directing them to relevant divisions. Moreover, action had not been taken as well to formulate national policies for the advancement of the film industry. It is the vision of the Corporation to mobilize local creative talent to develop Sri Lanka's cinema industry to be in par with world standards. Nevertheless, there had been hindrances for new producers to proceed further on non-provision of required financial facilities and earning money by focusing on commercial films instead of producing quality creations had become the main objective.

## 4.2 Management Activities

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The following observations are made.

- (a) Even though there was an excess of 10 labourers in the Corporation, the cleaning activities of the Corporation had been awarded to a private service supplier who had been rejected by the Technical Evaluation Committee, on the agreement of a monthly payment of Rs.293,490 and an unsatisfactory service had been supplied continuously due to failure in deploying the required number of employees by this institution.



- (b) In terms of Letter No.PE/ME/NFC/GEN/2015 of August 2015 of the Director General of the Department of Public Enterprises, as reply to the letter of requesting approval for writing off outstanding monies recoverable from cinema halls to the Corporation and the loan of Rs.192 million granted for production of films, it was observed that the following deficiencies had occurred.
- (i) As recommended by the Parliamentary Committee on Public Enterprises, it had been instructed to appoint a committee at Ministerial level and formulate a proper methodology for collecting outstanding monies. However, there had been no representation from the Ministry for the appointed committee.
  - (ii) Failure in investigating on the legal ability for recovery of the relevant loans and not taking legal action to recover the relevant outstanding amounts from debtors identified through such investigations.
  - (iii) Non-preparation of a proper procedure by the above mentioned committee to settle the loan granted at least from the cinema halls functioning at present, in installments or on long term basis.
  - (iv) Failure in obtaining the approval of the Cabinet by submitting a Cabinet Paper for writing off the remaining amount except for the loan amount that could be recovered as mentioned in (ii) and (iii) above, despite having informed earlier.
- (c) Action had not been taken even by the end of the year under review to obtain legal ownership and account the value of the land bearing assessment number 303 at Baudhdhaloka Mawatha on which the building of the Corporation is located.

#### **4.3 Uneconomic Transactions**

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In investing Treasury Bills and Treasury Bills Repurchasing, investments had been made in the same bank continuously and investments had not been made on more beneficial interest rates by calling for quotations from state banks in the primary market. A sum of Rs.264,903,027 had been invested as at 31 December 2016 at a percentage of about 0.2 per cent, lower than the weighted average interest rate at the auction of Treasury Bills issued by the Central Bank.

#### **4.4 Transactions of Contentious Nature**

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The following observations are made.

- (a) The Chairman of the Corporation had recommended liquor permits in the year under review to 39 cinema halls of the Ridma Circuit and 16 cinema halls of other circuits since many years without any connection whatsoever with the objective of the Corporation and without being based on legal provisions.

- (b) The issue of liquor permits under state patronage is an action against the “Mathata Thitha” policy of the Government of Sri Lanka and even in instances of screening family films and children’s films, the recommendation of liquor permits for cinema halls to enable intake of liquor, is observed as a contentious matter.
- (c) In terms of permits issued, liquor should be sold only to viewers. However, it was observed that liquor had been sold to people who were not viewers and the right of selling liquor had been given to external persons.

#### **4.5 Underutilization of Funds**

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The monthly average balance of 8 bank current accounts of the Corporation amounted to Rs.55,560,598 and an extra income could have been obtained by short term investment of a part of that amount. Nevertheless, attention had not been paid therefor.

#### **4.6 Idle and Underutilized Assets**

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The following observations are made.

- (a) The stock of negative films and chemicals totalling Rs.870,659 had remained without being issued since the year 2014.
- (b) The Vehicle Mechanical Consultant had condemned the Three Wheeler valued at Rs.156,800 on 22 September 2017 as carrying out repairs by spending Rs.200,000 is ineffective. Nevertheless, action had not been taken to dispose of it.
- (c) Over 500 library books provided to the library by the Welfare Society of the Head Office were being decayed due to stacking them in an unprotected manner in the Sarasavi Studio in Kelaniya.

#### **4.7 Delayed Projects**

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Treasury provisions amounting to Rs.30 million had been received in the year 2015 to improve the post production facilities of films in the Sarasavi Studio and bids had been called therefor. However, they had been cancelled due to non-conformity with the specifications of the Corporation. Even though a sum of US\$ 8,000 had been paid to an Indian Consultant for the preparation of required specifications and future activities, this project had not been commenced even by May 2017. Moreover, only the consultancy services necessary for completing the project under 03 phases in the year 2017 had been obtained.

## **4.8 Staff Administration**

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The following observations are made.

- (a) The number of vacancies of the Corporation as at 31 December 2016 stood at 71 and according to present requirements, the approved cadre had not been reviewed and as such, 02 essential posts of staff grade had been vacant for some time. As a result, it was observed that it could be problematic in the preparation of plans, setting up targets and monitoring in order to achieve those targets under the guidance and supervision of the top management.
- (b) Even though it had been planned in the year 2016 to fill the vacancies of the Corporation by calling applications from external applicants, no recruitment whatsoever had been made up to 12 July 2017.

## **5. Accountability and Good Governance**

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### **5.1 Corporate Plan**

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Even though a Corporate Plan had been prepared by the Corporation, an Action Plan had not been prepared in the year 2016 and taken action accordingly.

### **5.2 Action Plan**

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The Action Plan for the year under review had not been prepared based on the objectives of the Corporate Plan. Even though the targeted activities of the Action Plan had not been identified quarterly, the performance report had not been prepared in a manner to enable the evaluation of its performance.

### **5.3 Internal Audit**

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According to the approved cadre, there should be 03 permanent posts of Audit Assistant in the Internal Audit Unit. However, no assistant had been deployed by 31 December 2016. As such, it was observed that the Corporation had not paid adequate attention towards the internal audit activities.

### **5.4 Audit Committee**

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In terms of Section 7.4.1 of Public Enterprises Circular No. PED/12 of 02 June 2003, audit committee meetings should be held at least once in three months. Nevertheless, only 02 meetings had been held in the year under review.

## 5.5 Procurement Plan

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In terms of Guideline 4.2.1 (b) of the Procurement Guidelines, a Master Procurement Plan for expected procurement activities and a Procurement Time Schedule in terms of Section 4.2.2 should be prepared. However, the Procurement Plan had been prepared only for the year under review. Even though a sum of Rs.16 million had been allocated for purchase of carbon as an urgent requirement, computer network, **converting current cinema packages to digital technology quality tests** and a sum of Rs.15 million had been allocated for purchase of computer accessories and generators as ordinary requirements, those purposes had not been achieved.

## 5.6 Tabling of Annual Reports

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In terms of Section 6.5.3 of Public Enterprises Circular No. PED/12 of 02 June 2003, the Annual Reports of years 2013 and 2014 had not been tabled in Parliament even by 23 May 2017.

## 6. Systems and Controls

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Weaknesses in systems and controls observed during the course of 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 Control	Observations
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(a) Assets Control	(i) Failure in taking necessary action by identifying the idle assets remaining in the studio
	(ii) Maintenance of library books in an unprotected manner
	(iii) Improper maintenance of the Inventory so as to easily identify receipts and issues
(b) Debtors Control	(i) Failure in taking necessary action in respect of loan balances remaining unrecovered over a period of 10 years
	(ii) Lack of proper supervision over loan agreements
	(iii) Lack of an arrangement in the recovery of loans or non-establishment of a unit therefor

- (c) Control of Income
  - (i) Lack of supervision on the income from film rentals and tax recoverable annually
  - (ii) Paying the part of income from rentals of the producer without confirming the income received in cash from cinema halls
  
- (d) Debt Control
  - Non-recovery from the first income in the recovery of loans on publicity of films, in terms of agreements
  
- (e) Control of Computer Software Systems
  - (i) Failure in providing passwords for the level of each officer and personally as well
  - (ii) Failure in carrying out the change of data in the Master File and non-supervision by a staff officer
  - (iii) Keeping the backups received, in their places
  - (iv) Running a risk in accessing the salary preparation system by external persons through Teamviewer software and internet facilities