Kulubowitiyana Tea Factory Limited – 2017/2018

The audit of financial statements of the Kulubowitiyana Tea Factory Limited for the year ended 31 March 2018 comprising the statement of financial position as at 31 March 2018 and the profits or losses and other comprehensive income statement, 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. My observations on the performance of the Company of the year under review, which I consider should be tabled in 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 of Directors' Responsibility for the Financial Statements

The Board of Directors 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 of Directors 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 judgement, including the assessment of the 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 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 financial statements.

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

1.4 Basis for qualified Opinion

(a) Information such as temporary differences with relating to the calculation of deferred tax, unused tax losses and tax credits had not been disclosed in financial statements in terms of paragraph 81 (g) of Sri Lanka Accounting Standard 12.

(b) The assets costing Rs. 225,098,311 had been fully depreciated as the useful life of non-current assets had not been reviewed annually in terms of paragraph 51 of Sri Lanka Accounting Standard 16. However, they had still been in use. Accordingly, actions had not been taken to revise the estimation error in terms of Sri Lanka Accounting Standard 8.

(c) Though assets pledged as security for liabilities should be disclosed in financial statements in terms of paragraph 74 (a) of Sri Lanka Accounting Standard 16, the land premises of Kalubowitiyana tea factory as a part of land amount of Rs.4,605,691 shown in financial statements had been pledged for the purpose of loan taken by the Company for working capital activities but not disclosed in this regard.

(d) Though actuarial valuation system had been used to calculate employee benefit obligation, basic assumptions such as discount rate, expected benefit percentage, expected salary increasing ratio etc. had not been disclosed in terms of paragraph 76 (b) of Sri Lanka Accounting Standard 19.

(e) Though the financial assets should be maintained at impaired cost by categorizing as investments help for maturity after the initial identification in terms of paragraphs 45 and 63 of Sri Lanka Accounting Standard 39, this had not been maintained with regarding financial assets of Rs. 123,703,732.

(f) Though the loan of Rs. 10,000,000 given to B.C.C. Lanka Company in the year 2003 and its accumulated interest of Rs. 40,174,692 had been disclosed in the financial statements as at 31 December of the year under review, that loan and interest had not been recovered from 15 years. However, provisions had not been made by the Company in the financial statements in terms of paragraph 58 of Sri Lanka Accounting Standard 39 by considering feasibility of the recovery of that loan.

(g) Though the income tax rate used to compute differed tax liability and expenditure in the year under review in terms of Inland Revenue Act should be 14 per cent, the differed tax liability and its expenditure had been understated by Rs. 1,986,552 due to using the rate as 10 per cent.

(h) The cost and accumulated depreciation of the dryer which had been sold at Rs.1,000,000 in the year 2014/2015 and fully depreciated, had not been identified and adjusted into the accounts even as at the year under review.

(i) Though a sum of Rs. 6,194,940 spent in the year 2012/2013 for painting and building repairs of Hiniduma Hills Tea Factory taken on lease basis had been capitalized as buildings of that year, further sum of Rs. 1,238,988 had been written off against the profit during the year as depreciation due to non-taking actions to rectify that error during the year under review as well.

(j) According to the actuarial valuation report; though the provision for gratuity of the year under review was Rs. 2,962,416, the provision for gratuity had been understated by Rs. 1,842,288 with relating to the year under review due to accounting as Rs. 1,120,128 in the financial statements instead of accounting that amount.

(k) Though the bank overdraft as at the end of the year under review should be Rs.60,514,715, it was shown as Rs. 59,952,624 in the statement of the financial position and that difference of Rs. 562,091 had been shown in the statement of financial position as unpaid incentives.

(l) A sum of Rs. 1,046,771 payable with regarding the supply of green leaf to Menikdiwela factory in the year 2015/2016 had not been accounted and due to debiting that amount paid in the year 2016/2017 into sundry debtors instead of adjusting into the retaining profit, the excess was shown in retain profit and sundry debtors balance in the financial statements by that amount.

(m) Though a sum of Rs. 109,730 paid for developing a web page and installation of internal telephone system should be capitalized, it had been accounted as maintenance expenditure of office equipment.

(n) According to the profit and loss account in the year under review though the sundry income amount was Rs. 16,517,315, it was Rs. 16,686,710 as per the schedule hence the difference was Rs. 169,395.

(o) The detailed schedule for the provision for bad debt of Rs. 1,551,170 for the year under review had not been presented to audit.

(p) Though the loan amount of Rs. 50,000,000 given to Tea Shakthi Fund on 09 April 2015 had been disclosed under financial asset, the existence, accuracy. Completeness of those balances could not be verified in audit due to non-providing documentary evidence such as agreements and balance confirmations.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.4 of this report, the financial statements give a true and fair view of the financial position of the Kalubowitiyana Tea Factory Limited as at 31 March 2018 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 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.

2.3 Accounts Receivable and Payable

Debit balances of Rs. 699,918 had been included in balances of sundry creditors with relating to three factories and those had not been settled.

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

The following instances of non-compliance with laws, rules, regulations, etc. were observed.

	Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a)	Employees' Provident Fund (Amendment) Act, No.01 of 1985 Section 9 (2)	In the computation of the contribution for the Employees' Provident Fund for the Company, the contribution should be computed subsequent to addition of the Cost of Living Allowance to the basic salary. However, it had not been so done and as such, a short of Rs.1,695,177 had been remitted to the Fund from 01 April 2012 to 30 September 2017.
(b)	Sections 8 and 12 of General Contract Act No.03 of 1987	Though the Officers of Procurement and Evaluation Committees should not deal with bidders who did not have valid registration certificate under General Contract Registrar, the contract of construction a fence surrounding Kalubowitiyana tea factory premises had been awarded without considering in this regard.
(c)	Financial Regulation 371 of Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka and Sri Lanka Public Finance Circular No. 03/2015 dated on 14 July 2015	Though the advances given, should be settled immediately after the completion of due activity; actions had not been taken to settle a sums aggregating Rs.240,423 given in 06 instances in the year under review and a sum of Rs. 1,329,035 given in previous years, for more than 05 months and 1 year to 7 years period respectively.

(d)	Public Enterprises Circular No. PED/12 dated on 02 June 2003	
	(i) Paragraph 7.2	The Company had not prepared an Operation Manual as per the Circular
	(ii) Paragraph 9.2 (d)	Organization structure and approved cadre of the Company had not been registered in Public Enterprises Department of General Treasury.
(e)	Public Enterprises Circular No. 1/2015 dated on 25 May 2015	The officer engaged in Management Service Assistant post, who is not entitled for official vehicles as per the circular, had been paid transport allowances of Rs.600,000 in the year under review by Rs.50,000 monthly.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Company for the year under review had been a loss of Rs. 7,587,359 as against with the corresponding profit of Rs. 29,270,215 of the revised financial statements for the preceding year, thus indicating a decline of Rs. 36,857,574 or 126 per cent in the financial result of the year under review as compared with the preceding year. Decrease in gross profit by Rs.31,739,627 and increase in administration expenditure by Rs. 6,772,885 in the year under review as compared with the previous year had been the main reasons for the above decline.

Though the Company had continuously been profit making when analyzing the financial result of the year under review and previous 4 years, a loss of Rs. 7,587,359 had been generated in the year under review. However when readjusting employees emoluments, deprecations for non-current assets and taxes paid to the Government into the financial result; though the contribution of Rs. 87,547,097 of the year 2013/2014 had continuously been increased up to Rs. 136,878,603 in the year 2016/2017, it had been decreased up to Rs.62,446,219 in the year 2017/2018.

3.2 Analytical Financial Results

The following observations are made.

(a) Gross profit ratio remain at 5.67 per cent in previous year had been dropped up to 2.12 per cent in the year under review. The increase in tea producing cost in the year under review by 9.5 per cent as per the compare with the previous year had impacted on this.

(b) Though a sum of Rs. 6.31 had been earned per share in the previous year from operating activities of the Company, earning per share for the year under review had been dropped up to unfavourable amount of Rs. 1.64.

3.3 Legal Action initiated against / by the Company

The following observations are made.

(a) A case which had been filed in the Kotapola Labor Tribunal against the Company in the year 2007 in respect of unfair dismissal of two employees from the service, was on trial at the Court even by the end of the year under review.

(b) A case had been filed in the Court of Appeal by the Department of Inland Revenue against the judgment given by the Tax Appeals Commission stating that the basis of payment of income tax of the Company in the year 2010/2011 was correct.

4. Operating Review

4.1 Performance

4.1.1 Planning

Though the approval of the Board of Directors had been obtained for the Corporate Plan prepared by the Company for the period 2016- 2019, updated Corporate Plan had not been presented to Public Enterprises Department in terms of Paragraph 5.1.3 of Public Enterprises Circular No. PED/12 dated on 02 June 2003.

4.1.2 Implementation and Review

The factories such as Kalubowitiyana, Derangala, Hiniduma and Menikdiwela are in operation under the Kalubowitiyana Tea Factory Limited which was incorporated on 16 June 2009 as a Limited Company under the Companies Act, No.07 of 2007 and following observations are made with regarding the performance of those factories.

(a) Tea Production

Details of tea production for the year under review and preceding 02 years were as follows.

Tea Factory	Year								
	2017/2018			2016/2017			2015/2016		
	Green Leaf	Made Tea	Outturn	Green Leaf	Made Tea	Outturn	Green Leaf	Made Tea	Outturn
	kg	kg	%	kg	kg	%	kg	kg	%
Kalubowitiyana	3,499,414	731,750	20.91	3,907,343	811,708	20.77	4,774,872	994,540	20.83
Derangala	1,474,475	289,634	19.64	2,113,499	429,382	20.32	2,249,785	460,860	20.48
Hiniduma	1,224,781	242,955	19.84	1,235,145	253,157	20.49	1,095,511	219,765	20.06
Menikdiwela	1,097,625	210,107	19.14	1,033,575	209,464	20.26	577,406	117,017	20.26

Following observations are made in this regard.

(i) According to the criteria of Tea Board, though a production level of 21.5 kilograms of made tea should be maintained as a minimum from 100 kilograms of green tea leaf, the own tea production had not been maintained in standard level at 04 tea factories during the year under review as shown in the above. As the reason of that, a sum of Rs.52,214,143 had been lost in the year under review from the expenditure on average green leaf price. Non using of green leaf in high quality for the production had mainly been affected for this.

(ii) Factory Management had failed to improve made tea percentage as well as to obtain high net selling price as the expected objectives, though an extra amount of Rs. 3,939,425 had been spent during the year under review to purchase "Super Bud" for the four factories under the concept "Super Bud" introduced by the factory from November 2016 for the improvement of the quality of purchased bud with the view of improving the made tea percentage.

(b) Production Cost and Net Sales Average Price

According to the information presented to audit by the Company, production cost and net sales average prices of 04 factories of the Company for the year under review and 02 previous years were as follows.

Factory	Production Cost per Tea kilo			Net Sales Average Price per Tea kilo			Contribution per Tea kilo		
	2017/18 Rs.	2016/17 Rs.	2015/16 Rs.	2017/18 Rs.	2016/17 Rs.	2015/16 Rs.	2017/18 Rs.	2016/17 Rs.	2015/16 Rs.
Kalubowitiyana	633.83	507.08	407.63	733.26	575.75	459.72	99.43	68.67	52.09
Darangala	727.17	553.13	430.72	647.12	557.78	413.50	(80.05)	4.65	(17.22)
Hiniduma	725.40	575.79	459.03	628.29	524.96	402.43	(97.11)	(50.83)	(56.60)
Manikdiwela	660.80	572.46	522.58	558.57	472.65	375.09	(102.23)	(99.81)	(147.49)

(i) The production cost of a made tea kilo in every factories belonging to the Company had been increased ranging from 15 per cent to 31 per cent as compared with the previous years, and the production cost of a made tea kilo in Hiniduma, Manikdiwela and Darangala factories had been exceeded the net sales average price. Therefore those factories had continuously been made losses due to the unfavorable contribution in a made tea kilo. Increased in absorbed fixed cost of a tea kilo due to the incapability of purchasing of expected volume of green leaf, and being the labor productivity in lower level had been the reasons in increasing the production cost of the made tea kilo.

(ii) According to the report issued by the Tea Board, selling prices of two factories in low grown Hiniduma factory and middle grown Manikdiwela factory had been reported an adverse variations of 16.13 per cent and 6.96 per cent respectively as compared with the monthly net sales average price of made tea and net sales prices of low grown and middle grown tea.

(c) Capacity Utilization /Targeted Tea Production

According to the Action Plan for the year under review, targets had not been included for the production of tea for each factory and according to the budget of the Company, the targeted and actual tea production and plants utilization in factories are as follows.

Factory	Targeted Tea Production according to the Budget	Actual Tea Production	Percentage of Variance Advantages/ (Disadvantages)	Production Capacity	Percentage of Underutilization
	Kg	kg		kg	
Kalubowitiyana	1,032,000	731,750	(29)	1,350,000	45.80
Darangala	425,055	289,634	(32)	485,000	40.28
Hiniduma	365,000	242,955	(33)	485,000	49.91
Manikdiwela	386,033	210,107	(46)	450,000	53.31

(i) It was observed that, all the factories had been operated on less capacity of more than 40 per cent in the year under review and Manikdiwela tea factory which had been commenced it operation in the year 2015, had been in less utilization more than 53 per cent of the capacity from the beginning.

(ii) According to the budget of the year under review, every factory had failed to achieve targeted tea production ranging from 29 per cent to 46 per cent and decrease in input green leaf had been affected to it.

(d) Tea Nursery

Tea nursery attached to the Derangala tea factory had been initiated with a view to supplying standard tea plants. Even though the capacity of this commercial twig tea nursery stands at 100,000 plants, the total number of tea plants in the nursery of the year under review stood at 71,150. As such, it represented only 71 per cent of the total capacity of the nursery.

(e) Achieving of Main Performance Target

Observations with regarding the achievement of main performance indexes set out by the Company to measure the performance of Head Office and the factories were as follows.

Performance Index	**Kalubowitiyana**		**Manikdiwela**		**Hiniduma**		**Darangala**	
	Target	Achievement	Target	Achievement	Target	Achievement	Target	Achievement
Made Tea (Percentage)	21.5	20.9	21.5	19.1	21.5	19.8	21.5	19.06
Labor Productivity (Monthly Made Tea kilogram per Employee)	90	93.78	34	22.61	34	25.08	34	22.19
Waste Tea (Percentage)	2	0.59	8	13.55	8	2.07	8	1.78

Though Labor Productivity Performance Index had been achieved by Kalubowitiyana tea factory, other 3 tea factories had not been reached up to the expected performance levels. Though the waste tea at the production of Manikdiwela tea factory were 8 per cent, Company had failed to improve effectiveness of green leaf in that factory as actual waste tea amount was 13.55 per cent.

4.2 Management Activities

The following observations are made.

(a) Though tea factories belonging to Tea Shakthi Fund that is Hiniduma and Manikdiwela the one which was under constructing that time, had been taken into the Company in the years 2012 and 2015 on long term lease basis for 30 years; the agreement had not been signed with Tea Shakthi Fund even as at 31 August 2018.

(b) Two Color Separator Machines had been installed in two factories in Manikdiwela and Hiniduma by spending a cost of Rs. 25,750,083 on 21 August 2017 with a view of reaching high net sales price in the tea auction by increasing the quality of made tea. However it was unable to get a higher price for tea as expected.

4.3 Staff Administration

The following observations are made.

(a) According to the information presented by the Company, the cadre approved by the Department of Management Services for the Head Office stood at 33 and the actual cadre was 30. Out of them, six persons had been recruited on contract basis. The approved cadre for the factories stood at 100 and the actual cadre was 86. Out of them, four persons had been recruited on contract basis and 20 workers on days pay basis.

(b) Though recruitment procedure had not been approved for the post of Sales Assistant in the Head Office, two officers had been recruited for those posts and 03 excess persons had been recruited for more than the approved number of posts in Management Assistant at Head Office.

5. Sustainable Development

5.1 Achieving of Sustainable Development Goals

Every Government Institution should comply with the "Agenda" of United Nations year 2030 for Sustainable Development and Kalubowitiyana tea factory had not aware the way how it should implement activities falling under its scope. Following observations are made in this regard.

(a) Necessary financial provisions had not been included in the annual budget to implement the activities identified by the Institutions to achieve sustainable development target.

(b) It was observed that the planning and prior preparation process to achieve targets and objectives had been in slow progress due to improper coordination with other Institutions at the time of preparation for achieving sustainable development targets.

6. Accountability and Good Governance

6.1 Internal Audit

Though an Internal Auditor had been appointed for the Company sufficient staff cadre had not been assigned for the implementation of internal audit activities.

6.2 Procurement and Contract Process

6.2.1 Procurement

Following observations are made with regarding the Procurement Plan and procurement activities performed.

(a) Paragraph 4.2 of Government Procurement Guideline; though main procurement plan should be prepared by the procurement entity by listing out expected procurement activities for a minimum period of 03 years, it had not been complied accordingly.

(b) Though a procurement plan had been prepared for the year under review, procurement plan had not been updated as per the Guideline 4.2.1 (b) and 4.2.1 (e) of Procurement Guideline.

(c) Though the new packages had been printed in the year under review by spending a sum of Rs. 1,656,974, that activity had not been included in the procurement plan. According to the Guideline 5.4.4 (1) of Procurement Guideline, though advances of 20 per cent could be given by obtaining security, an advance of 30 per cent had been given for this procurement activity without obtaining a security.

(d) According to the Guideline 8.9.1 of Procurement Guideline, though it was needed to be engage into an agreement prior to the awarding for procurement for more than Rs. 500,000, it had not been complied accordingly when procuring C.C.T.V system for Rs. 665,200 and Computer Software System for Rs. 2,500,000.

6.3 Budgetary Control

It was observed that the budget had not been used as an effective management control tool as observing variance between 9 per cent to 107 per cent in budgeted and actual income and expenditure.

6.4 Unresolved Audit Paragraphs

Though it was ordered in the Committee on Public Enterprises held on 27 February 2013 to recover the sum of Rs.789,461 receivable from a Broker Company in the year 2009, those amount had not been recovered up to the end of the year under review.

7. 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 Systems and Controls		Observations
(a)	Procurement Activity	Non-compliance with some Government Procurement Guidelines.
(b)	Balances Receivable and Payable	Failure in recovery and settlement of balances remaining for a long time.
(c)	Financial Control	Payment of a large amount of interest on the bank overdraft
(d)	Control of Factory Operations	Failure in taking actions to minimize the production cost and directed factories towards profitability
(e)	Assets Management	Failure in proper acquisition of assets and assets remaining in idle
(f)	Maintenance of Registers	Failure in updating the Register of Fixed Assets