State Timber Corporation – 2017

The audit of financial statements of the State Timber Corporation for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017, 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 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.

1.2 Management's Responsibility for the Financial Statements

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

1.3 Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of risks of material misstatements of the financial statements, whether due to fraud or error. In making those risks assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

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

1.4 Basic 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 effect 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 2017 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 Standard - 16

Even though, assets costing Rs.227,566,848 fully depreciated had been further utilized as useful life of non-current assets had not been reviewed annually in terms of paragraph 51 of the standard. Accordingly, action had not been taken to revise the estimated error in terms of Sri Lanka Accounting Standard 8 and shown the correct carrying value in the financial statements.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) Economic Service charge of Rs.5,630,297 payable for the year under review had not been brought to accounts.

(b) The value of sawing blades amounting to Rs.915,178 purchased in the year 2015 had been shown under capital work-in-progress instead of being accounted as recurrent expenditure.

(c) Expenditure of Rs.834,124 incurred for the re-arrangement of iron racks fixed in kaldemulla Attimaduwa had been brought to accounts under work-in-progress, instead of being adjusted to the statement of profit and loss.

2.2.3 Unreconciled Control Accounts

A balance of Rs.75,458,361 as sundry creditors in the Head Office as at 31 December 2016 had been brought forward in the year under review and payments had been made through the creditors account for expenditure not included in the year under review or in the year 2016 as creditors. Furthermore, payments had not been made during the year under review for certain creditors balances included in the creditors schedule of the Head Office presented as at 31 December 2016 and those balances had not been included in the creditors schedule as at 31 December of the year under review. Accordingly, the correctness of the creditors balance of Rs.130,272,172 as at 31 December of the year under review had been problematic.

2.2.4 Unexplained Differences

The following observations are made.

(a) According to the financial statements, Nation Building Tax and the Value Added Tax payable balance amounted to Rs.50,386,639 whereas such balance according to the relevant tax returns amounted to Rs.52,558,485 and as such a difference of Rs.2,171,846 was observed.

(b) A total difference of Rs.1,450,440 was observed between the balances as per financial statements in 4 items of accounts, namely, Employees Trust Fund, Employees Provident Fund, Employees Trust Fund payable and Employees Provident Fund payable accounts and the balances as per the schedule.

2.2.5 Lack of Evidence for audit

A sum of Rs.39,531,327 shown in the sundry creditors account of the Head Office as at 31 December of the year under review as provisions for the payments to be made to the Department of Conservation of Forest being brought forward since several years having being fluctuated and the detailed schedule relating to that balance was not made available to audit.

2.3 Accounts Receivable and Payable

The following observations are made.

(a) A sum of Rs.11,873,954 receivable from a private company since the year 1983 and balances of Rs.11,003,176 receivable from government and semi-government entities lapsed for more than 5 years had been included in the Trade and other receivable balance as at 31 December of the year under review and action had not been to recover same even during the year under review.

(b) Building rent amounting to Rs.19,980,000 receivable from the Department of Conservation of Forest since the year 2015 had not been recovered even by the end of the year under review.

(c) Salaries and wages totalling Rs.1,226,970 payable to the employees of the Regional Offices of the Corporation as at 31 December of the year under review had not been paid and settled it even by June 2018.

2.4 Non-compliance with laws, rules, regulations and management decision

The following non-compliances with laws, rules, regulations and management decisions were observed.

Reference to Laws, Rules etc.	Non-compliance
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka.	
(i) Financial Regulation 371 and Public Finance Circular No.03/2015 of 14 July 2015.	Ad-hoc sub-imprests elapsed for more than 4 years totalling Rs.11,491,279 given for the work sites of the Corporation had not been settled even up to May 2018.
(ii) Financial Regulation 571	Action had not been taken to settle or to take into revenue in terms of Financial Regulation 571(2) in respect of deposits amounting to Rs.133,800 lapsed for more than 2 years. Security deposit of Rs.840,000 lapsed for periods 2 to 5 years and Gangnail deposits of Rs.1,258,635 older than one year.
(b) Establishments Code of the Democratic Socialist Republic of Sri Lanka.	
Sub-section 1.2 of section XXXII	Even though, an Administrative Officer attached to the Kaldemulla Mechanical Division had engaged full time in political affairs while he was in service, action had not been taken in terms of the Establishments Code. Action had also been taken to pay a sum of Rs.1,260,364, being adjusted the salary increments for the period 2004 to 2017.
(c) Procurement Guidelines 2007 on the selection and employment of consultancy services.	Without following the provisions of the guidelines, a sum of Rs.5,230,774 had been paid to the consultancy services entities in respect of obtaining consultancy services for 17 construction contracts valued at Rs.257,263,277 during the period 2013 to 2017.

3. Financial Review

3.1 Financial Result

According to the financial statements presented, the operation of the Corporation had resulted in a surplus of Rs.565,741,554 for the year under review as compared with the surplus of Rs.86,678,961 for the preceding year thus, an improvement of financial results by Rs.479,062,593 in the year as compared with the preceding year was observed. Increase of sales income by Rs.39,818,582 and decrease of selling and distribution expenses, Administrative Expenses and taxes paid to the Treasury by Rs.84,406,064, Rs.122,145,217 and Rs.75,000,000 respectively had attributed to this increase.

In the analysis of financial results of the year under review and the preceding 4 years, the financial results had continuously increased from 2013 to 2015 and it had deteriorated in the year 2016 and improved again in the year under review. However, after being adjusted employees remunerations, depreciation and tax for the year to the financial results, the contribution had improved continuously from 2014 to the year under review and it had improved by 5 per cent in the year under review as compared with that of the preceding year.

3.2 Analytical Financial Review

The following observations are made.

(a) Even though, the gross profit ratio of the Corporation had been a high value of 49 per cent, the net profit ratio had dropped as compared with the gross profit, as income tax, administrative expenses, selling and distribution expenses, salaries and wages in addition to cost of production had increased continuously as compared with the previous years.

(b) The current ratio and the quick assets ratio in the year had been a low value as compared with the previous year and the quick assets ratio had indicated a low value than the current ratio. It indicated that the money had largely tied up with the stock of the Corporation.

4. Operating Review

4.1 Performance

4.1.1 Operations and Review

The following observations are made.

(a) The Corporation had not taken action to fulfil the objectives such as import of agricultural products and wicker and export of timber related finished goods and semi-finished goods out of the principal objectives of the Corporation and timber by products had also not been manufactured and sold as expected. The export of timber sleepers had dropped by 70 per cent in the year under review as compared with that of the previous year.

(b) According to the Corporate Plan prepared by the Corporation for the period 2016-2020, such programmes as the introduction of timber harvesting contract management systems and project management systems, taking action to prevent timber wastage, preparation of programmes for the establishment of procedures to ascertain statistics on trees through correct methodology, allocation of Rs.2 million each annually for the development of professional skills and of the logging contractors and provide facilities therefor and the allocation of Rs.10 million each for the purchase of modern plant and equipment for the harvesting process had not been executed up to now.

(c) Even though, the overall sales income of the year under review had increased by 01 per cent as compared with the previous year, sales income of private timber logs, sales income of sleepers in private and government lands, sales of imported sleepers, sales income of electricity and telephone fence pillars etc. had decreased by ranging from 30 per cent to 75 per cent as compared with that of the previous year. Sales income of exported sawn timber had only increased by 0.85 per cent.

(d) Even though, the total net profit of the Corporation for the year under review amounted to Rs.966,804,360, of the 12 Regional Offices, a loss totalling Rs.16,990,112 in 2 Regions of Ampara and Polonnaruwa, a total loss of Rs.52,044,023 in 2 timber complex of the Corporation out of 3, a total loss of Rs.52,308,236 in 2 workshops out of 3 and a loss of Rs.30,750,890 in Kaldemulla Technical Unit, all together Rs.152,093,261 had incurred.

(e) According to the objectives of the Corporation, sales income of furniture is one of the major income earning sources but the income on sales of furniture of the year under review had been as insufficient low level as 9 per cent of the overall sales income. The total profit of the furniture unit in the year under review amounted to Rs.985,596, representing 0.1 per cent of the total profit of the Corporation. Accordingly, new marketing strategies required to increase the sales income of furniture had not been followed even though the Corporation had a monopolistic right in obtaining State Timber.

(f) According to the budgeted sales of the Corporation for the year 2017, the targeted furniture sales income amounted to Rs.501,333,000 but actual sales income earned was Rs.389,044,488, being observed a difference of Rs.112,288,512. Accordingly, the targeted income could not be reached in the year under review.

(g) Even though, a gross profit of Rs.3,240,127 had been earned in the year 2015 by the Bussa Finger Joint Factory operated with the objective of manufacturing by products being used timber wastage process, the gross profit being Rs.2,253,536, declined by Rs.986,591 in the year 2016 and had become a gross loss of Rs.2,712,225 in the year under review. It had been a decline of 220 per cent as compared with the gross profit earned from sale of products at the finger Joint in the previous year. Accordingly, it was observed that a sufficient market for by products of the Corporation was not available.

(h) Of the 7 show rooms belonging to the Corporation a gross profit of Rs.33,521,024 had been earned by 4 show rooms in the year under review but the gross loss incurred by 3 show rooms in Thalalla, Bussa and Ampara totalled Rs.4,879,985. According to the statement in comprehensive income of the furniture unit, the net profit after, being adjusted the cost of sales and the administrative cost to this profit/ loss had decreased to Rs.985,596. Accordingly, it was observed that profits earned by those show rooms had not given sufficient contribution to the Corporation.

4.2 Management Activities

The following observations are made.

(a) The Keppetipola unit of the Corporation had obtained electricity posts from the trees taken from the lands belonging to the private parties and the balance timber had been sold at prices less than the prices stated in circulars, incurring a loss of Rs.1,051,346. Even though, instructions had been given by the Deputy General Manager (Internal Audit) by his letter dated 10 March 2016 that the loss should be recovered from the officer who had issued invoices or from the relevant buyers, a sum of Rs.629,318 thereof had not been recovered even by the end of the year under review.

(b) The contract for the fixing of new iron racks in the stacking shed at Kaldemulla Complex had been awarded to a private entity for Rs.2,052,500 without following the procurement procedure and without entering into an agreement with the contractor. As timber could not be stored in the racks fixed as planned, those iron racks had to be removed. Even though, the committee by which a financial investigation was conducted had recommended to recover the loss of Rs.834,124 incurred therein from the responsible officers, action had not been taken accordingly.

(c) Even though, sums of Rs.566,098 and Rs.94,906 had been spent in the year 2013 for the preparation of estimates and bid documents respectively in respect of the construction of Bandarawela Regional Office and the Keppetipola stores officers official quarters, such expenditure had become fruitless as those construction works had not been commenced.

4.3 Operating Inefficiencies

The following observations are made.

(a) Due to making lots in good condition timber logs together with defective timber logs in selling timber logs by auction, sales had to be effected at a lower rates and as such, good condition timber logs had also to be sold at lower prices.

(b) A sum of Rs.1,477,650 spent in the year 2013 for the design of construction work of Ratmalana show room had been shown under Kaldemulla partly completed buildings. However, construction works had not been commenced and the approval of the Board of Directors had been taken on 14 November 2014 to commence a construction works having being designed again but its work had not been commenced even by the end of the year under review.

(c) The income of the circuit bungalows of the Corporation for the year under review amounted to Rs.1,046,548 and the expenditure incurred amounted to Rs.6,667,018, being the expenditure over income amounting to Rs.5,620,473. However, the Corporation had not taken action to increase the income, being made aware of the external parties about circuit bungalows by introducing an effective methodology.

4.4 Idle and Under- utilised Assets

The following observations are made.

(a) A test physical verification carried out on 14 September 2017 observed that 116 items of spare parts valued at Rs.599,178 purchased before 25 years had been idle in the Boralanda Mechanical Spare parts store.

(b) As the vehicle washing yard in the Boralanda Technical Unit constructed 5 years ago had not been made at the specific standard, it could not be used and as such buildings, equipment and water remittance machines valued at Rs.2,094,677 had become idle.

4.5 Personnel Administration

The approved cadre of the Corporation and the actual cadre at the end of the year under review stood at 2308 and 1901 respectively. Accordingly, it was observed that a shortage of 440 officers in 65 posts and a surplus of 33 officers in 7 posts had existed. Shortages of staff included 6 posts in top management, 45 posts in middle management, 54 posts in lower management, 69 posts in Management Assistants Service and 266 posts in primary service.

4.6 Market Share

The following observations are made.

(a) The Corporation is the sole government entity in all sectors with the monophy of obtaining state timber, manufacture and sale of furniture and sale of timber. However, action had not been taken to conduct a periodical survey in order to determine the stability of the Corporation within the market and the market share of the Corporation.

(b) The Corporation possesses the least market share, even less than 0.45 per cent of the sale of furniture within the market, despite the availability of resources such as 52 timber stores and other resources including 6 market show rooms and having the government monophy, enabling to manufacture high standard furniture by obtaining state timber.

5. Sustainable Development

5.1 Reaching Sustainable Development Goals

Every public entity should act in accordance with the 2030 “Agenda” of the United Nations on Sustainable Development and the State Timber Corporation was aware about how it performs the functions coming under the scope of the Corporation. The following observations are made in this regard.

(a) On the acquaintance of the 2030 Agenda, the state Timber Corporation had taken action to identify such objectives as poverty alleviation, upliftment of economic level, new sustainable consumption and production to be reached in terms of its scope. Nevertheless, action had not been taken to identify data base targets for the upliftment of sustainable consumption and production, economic level and to make new products and the turning points to be reached and the indicators to measure the progress.

(b) Even though, the school teachers low income carpenters, sewers and contractors had been identified as the interested parties on the implementation of sustainable development goals, it was further observed that a participatory approach had not been depicted in the preparation of targets relating to the Corporation.

(c) Even though, the existence of a correct data base in order to measure the correct performance of any function is essentially required, the Corporation had not taken action to create a correct data base to measure the reaching of Sustainable Development Targets. It was further observed that insufficient financial provisions, insufficient physical facilities, lack of skilled employees had caused thereto.

(d) Functions identified by the Corporation for reaching Sustainable Development targets had not been included in the annual action Plan and the financial provisions to achieve those functions had also not been included in the annual budget.

(e) In the preparation of reaching sustainable Development targets it was observed that there was no appropriate coordination with other entities and as such the process of planning to reach targeted goals and preparedness had indicated a slackness or weak position.

6. Accountability and Good Governance

6.1 Procurements and Contract Process

6.1.1 Procurements

The following observations are made.

(a) Six items of capital nature not included in the Procurement Plan had been purchased by incurring an expenditure of Rs.9,415,858.

(b) A Master Procurement Plan (MPP), at least for a period of 3 years had not been prepared by the entity in terms of guideline 4.2 of the Government Procurement Guidelines.

6.2 Deficiencies in Contract Administration

The following observations are made.

(a) Even though, the construction works of Bandarawela Regional Office commenced on 21 November 2016 should have been completed by 26 May 2017, the works had not been completed even by May 2018. A sum of Rs.4,132,005 had been spent for additional works, exceeding 78 per cent of the contract value but approval of the Board of Directors and the Procurement Committee had not been obtained therefor.

(b) According to the budget of the year under review, the provision made for construction works amounted to Rs.238,400,000 out of which a sum of Rs.138,700,000 had not been utilized, representing 58 per cent of the overall provision. In terms of section 4.2.1 of the Good Governance Guidelines, the annual budget and the annual plans should be reviewed in order to determine for reaching targets and goals with confidence. Had action been taken in accordance with the directives in the good governance guidelines, it was observed in audit that such provisions could have been transferred to another economical transaction.

6.3 Budgetary Control

Variances between the budgeted income and expenditure and actuals ranging from 85 per cent to 1252 per cent were observed and as such the budget had not been made use of as an effective instrument of management control.

7. Systems and Controls

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

	Areas of systems and control	Observations
(a)	Fixed Assets Control	Existence of fixed assets not established and under-utilization of assets.
(b)	Debtors and creditors control	Non-recovery of loan balances receivable within the specific period, non-payment of royalty to external parties.
(c)	Personnel Administration	Recruitments and promotions not done in terms of establishments rules and regulations.
(d)	Procurement	Non-compliance with procurement guidelines.
(e)	Revenue Control	Tax computation in sales invoices not correctly recorded.