Sri Lanka Cement Corporation – 2017

The audit of financial statements of the Sri Lanka Cement Corporation for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the 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 read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 29 (1) of the State Industrial Corporations Act, No.49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2) (c) of the Finance Act, appear in this report. A detailed report in terms of Section 13(7)(a) of the Finance Act has been issued on 17 July 2018.

1.2 Management's Responsibility for the Financial Statements

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

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka 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. 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 Basis for Qualified Opinion

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

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the Sri Lanka Cement Corporation as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Consolidated Financial Statements

A sum of Rs.1,083,618,910 had been invested in 108,361,891 shares of Rs.10 of the Lanka Cement PLC in the year 1981 by the Corporation and the current market value of these shares had been Rs.617,662,779. Even though 62.45 per cent of the shares of the subsidiary of the Lanka Cement PLC, is owned by the Corporation, the consolidated financial statements for the year under review had not been prepared by the Corporation.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) Even though the cement factory and its land, located at Kankesanthurai had been legally vested with the Corporation by the Gazette Notification No.14012 of 17 April 1964, those assets had not been valued and brought to accounts.

(b) Sixty nine acres out of the land of 221 acres in extent, called Attawillu located at Palawi in Puttalam District, owned by the Corporation had not been valued and brought to accounts.

(c) The Aruwakkalu Limestone deposit of 5,352 acres in extent located at Puttalam District, owned by the Corporation had been leased out to the Holcim Lanka Ltd, (at present Siam City Cement (Lanka) Limited) for a period of 50 years. However, action had not been taken even by the year under review to value this asset which is the main source of income of the Corporation, and to record in the financial statements.

(d) Economic Service Charges totalling Rs.255,967 payable for the year 2013 and Rs.129,211 over paid due to erroneous computation in the year 2016 had been set off against each other with by ledger accounts without notifying the Department of Inland Revenue. As such, the balance of the Economic Service Charges Account payable as at the end of the year under review had been understated by Rs.129,211.

(e) Action had not been taken to account and pay the audit fees amounting to Rs.335,249 issued by the Auditor General's Department relating to the year 1990, the year of account as expenditure payable. Moreover, allocation of audit fees for the years 2016 and 2017 had been made based on the year 2015. As such, allocations for the year under review and the preceding year had been made less by a total of Rs.571,875.

2.2.3 Lack of Evidence for Audit

The evidence indicated against each following item of accounts had not been made available to Audit.

Item of accounts	Evidence not made Available
(a) Import of 8,600 metric tons of Cement in the year 2008.	Pay in vouchers, files maintained regularly and decisions of the Board of Directors relating to the total import of cement.
(b) Computers and Office Equipment	Cost of 32 Goods with a stock shortage according to the reports on Boards of Survey.

2.3 Accounts Receivable and Payable

The following observations are made.

(a) The trade and other receivable balance as at the end of the year under review totalled Rs.74,469,339 of which a total of Rs.11,510,027 between 01 year and 03 years and a total of Rs.58,179,621 over a period of 03 years had remained outstanding and action had not been taken to recover these outstanding loan balances.

(b) The trade and other payable balance as at the end of the year under review totalled Rs.42,317,003, of which a total of Rs.2,851,642 between 01 year and 03 years and a total of Rs.35,896,742 over a period of 03 years had remained outstanding and action had not been taken to settle these outstanding loan balances.

(c) The Value Added Tax totalling Rs.12,854,883 as at the end of the year under review relating to preceding years had not been paid to the Department of Inland Revenue.

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

The following non-compliances with Laws, Rules, Regulations and Management Decisions were observed.

Reference to Laws, Rules , Regulations etc.	Non-compliance
(a.) Nation Building Tax Act, No. 09 of 2009	Nation Building Tax amounting to Rs.8,410,618 that should be remitted to the Commissioner General of Inland Revenue, had not been remitted even by the date of this report.
(b) Financial Regulations of the Democratic Socialist Republic of Sri Lanka	
Financial Regulation 751	In terms of the Regulation, an inventory book had not been maintained.
(c) Public Finance Circular No.01/2014 of 17 February 2014	
(i) Section 05(1)(a)	Even though plans should be updated by evaluating strengths and weaknesses of the enterprise to accomplish the objectives, plans of the Corporation had not been updated by evaluating the objectives which could not be accomplished and objectives which could not be implemented.
(ii) Section 05(1)(d)	Even though the set out of targets to be achieved timely and the responsibility for accomplishing those targets to be delegated rationally up to operational level should be done, action had not been taken to set out the targets to be achieved annually and to delegate the responsibility for accomplishing those targets.
(d) Public Enterprises Circular No.PED/12 of 02 June 2003	
Section 9.4	Two employees had been released to the Lanka Cement PLC from 01 August 2017 without the approval of the Cabinet of Ministers during the year under review.
(e) Circular No.03/2015 of 14 July 2015 of the Ministry of Finance	The settlement of advances should not be delayed after 31 December of the Finance year of issuing advances. However, advances totalling Rs.240,946 granted in 13 instances from the year 2010 to the year 2015 had not been settled even as at the end of the year under review.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Corporation for the year under review had been a surplus of Rs.15,298,106 as compared with the corresponding surplus of Rs.31,700,843 for the preceding year, thus indicating a decrease of Rs.16,402,737 in the financial result of the year under review as compared with the preceding year. The decrease in the sales of the year under review by Rs.48,489,811 or 76 per cent and in other income by Rs.34,986,914 or 38 per cent had been the main reason for the decrease in the net profit as above.

Analysis of the financial results of the year under review and four preceding years revealed a deficit in the years 2013 and 2014. However, there was an annual surplus again from the year 2015 to the year under review. After readjusting the employees remuneration, tax paid to the Government and the depreciation for non-current assets to the financial result, the contribution of the Corporation which was a negative value of Rs.338,370,664 in the year 2013 had converted to a positive value since the year 2014. However, it had annually decreased and become a positive value of Rs.37,026,792 by the year under review.

4. Operating Review

4.1.1 Planning

The following observations are made.

(a) Plans such as the Human Resources Development Plan, Internal Audit Plan and the Plan for Loan Repayment which should be included in the Action Plan in terms of Section 02 and Section 5(2) of the Public Finance Circular No.01/2014 of 14 February 2014, had not been included in the Action Plan of the Corporation.

(b) In terms of Section 5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, targets set out in the Corporate Plan should be realistic and attainable. However, it was observed that objectives and targets which cannot be practically accomplished by an institution, from which employees had been retired by implementing a voluntary retirement compensation scheme, had been indicated in the Corporate Plan of the Corporation.

(c) The salient features such as the organizational structure, human resources and management skills, technical know-how, the current resources available with the institution and a review of the preceding three years' operating results which should be included in the Corporate Plan in terms of Section 5.1.2 of the said Circular, had not been included in the Corporate Plan of the Corporation.

4.1.2 Performance and Review

The following observations are made.

(a) Even though the manufacturing and selling of cement and manufacturing of cement related products are the main objectives of the Corporation, the manufacturing of cement at Kankesanthurai had been discontinued after the war remained during past years. Moreover, importation and selling of cement bags and production of concrete had been ceased by the end of the year under review.

(b) According to the Letter No.PE/RES/VRS of 20 October 2016 of the Additional Director General of the Department of Public Enterprises, activities such as determination of lease rental, finding out lessees for remaining lands including Kankesanthurai and updating lease agreements had been carried out by deploying remaining employees after providing compensation on voluntary retirement basis by the Corporation and out of that income, payments of employees had been made and the remaining should be remitted to the Government. Nevertheless, the Corporation had not taken action accordingly.

(c) The purchase of cement for sale by the Corporation had declined by 91 per cent in the year 2015 as compared with the year 2013 and that decline had been 90 per cent in the year 2015 as compared with the year 2014. The sale of cement had decreased by 77 per cent, that is, by Rs.46,146,262 in the year under review as compared with the year 2016. The discontinuation of importation and selling of cement after the first half-year of 2017 had been the reason thereto.

(d) The Concrete Manufacturing and Sales Division at Kankesanthurai was running at a loss due to incurring expenditure than the total sales income thereof. Moreover, the sale of concrete products within five preceding years had fluctuated ranging from Rs.25,620,000 to Rs.1,128,281 from the year 2014 to the year 2017. Further, the sale of concrete poles had declined by 72 per cent in the year under review as compared with the year 2016 and the discontinuation of manufacture of cement related products by the Corporation in the year under review had been the reason therefor.

4.2 Management Activities

The following observations are made.

(a) According to the cash book, the balance of a bank current account of the Corporation had been Rs.608,359 as at the end of the year under review, whilst according to the trial balance and financial statements, the balance of that bank current account had been Rs.2,156,449, thus indicating a difference of Rs.1,548,090. However, the management had not taken action to identify and rectify this difference remaining prior to the year 2008.

(b) The total value of payable bank loans obtained from State banks by the Management of the Corporation had been Rs.97,793,352 as at the end of the year under review. Moreover, the total interest on those bank loans paid during the year under review had been Rs.19,880,338 and a large financial cost had to be incurred for State banks annually due to inefficient financial management of the Corporation.

(c) Instructions had been given according to the Letter No.PE/RES/VRS of 20 October 2016 of the Additional Director General of the Department of Public Enterprises to take action for selling of shares of 62.45 per cent of the Lanka Cement PLC, owned by the Corporation at the share market and earn an income on behalf of the Government after the implementation of Voluntary Retirement Compensation Scheme. Nevertheless, the Management had not taken necessary steps therefor even up to July 2018.

4.3 Idle and Underutilized Assets

The following observations are made.

(a) Even though 297 acres out of the land of 741 acres in extent where the Kankesanthurai Cement Factory and its building complex are located, had been vested with the Corporation by a Gazette Notification, the documentary evidence on the ownership of remaining lands of 444 acres in extent had not been made available to Audit. This land, factory and buildings had remained as idling assets in the custody the Army at the High Security Zone.

(b) The land of 89.9 perches in extent located at Colpetty had been vested with the Corporation through the Gazette Extraordinary Notification No.14756/7 of 12 July 1967 and by the Deed No.288. This land to the value of Rs.735,000,000 by the year under review had been mortgaged to a State bank and obtained loans since the year 2008 and the outstanding loan balance as at the end of the year under review had been Rs.97,793,352. Moreover, this land located close to Galle Road had remained as an idle asset without being made use of for an effective purpose within a period of 50 years.

(c) One hundred and fifty nine acres out of the land of 221 acres in extent, called Attawillu located at Palawi in Puttalam District, owned by the Corporation had not been made use of for an effective purpose over a period of 40 years.

4.4 Uneconomic Transactions

The following observations are made.

(a) Even though 62.45 per cent ownership of the shares of the Lanka Cement PLC which was initiated in the year 1981, is owned by the Corporation, no benefits whatsoever for that investment had been received by the Corporation during the past 26 years.

(b) A number of 1,128 cement bags of 50 kg in weight, valued at a total of Rs.798,917 imported for the purpose of selling, had been sold for Rs.350,000 due to expiry of them, thus sustaining a loss of Rs.448,937 by the Corporation.

4.5 Staff Administration

The staff of the Corporation had retired by a Voluntary Retirement Compensation Scheme from 31 July 2016 and the actual cadre had been restricted to 14 persons by the end of the year under review. The approval of the Department of Management Services had not been obtained for the staff of the Corporation after implementation of the Voluntary Compensation Scheme.

5. Sustainable Development

5.1 Achievement of Sustainable Development Goals

Every Government Institution should act in terms of the 2030 "Agenda" for Sustainable Development of the United Nations. However, the Cement Corporation had not been aware of the manner in implementing the functions that come under its scope.

(a) As such, action had not been taken to identify the sustainable development goals, targets relating to those functions and focal points to reach those targets and indices for measuring the achievement of targets.

(b) The functions identified by the Corporation for the achievement of sustainable targets had not been included in the Annual Plan and the financial provisions necessary therefor had not been included in the Annual Budget.

6. Accountability and Good Governance

6.1 Presentation of Financial Statements

In terms of Section 6.5.1 of the Public Enterprises Circular No.PED/12 dated 02 June 2003, the financial statements and the draft annual report should be furnished to the Auditor General within 60 days from the close of the financial year. Nevertheless, the financial statements of the Cement Corporation for the year 2017 had been furnished to Audit on 29 March 2018.

6.2 Internal Audit

After the employees of the Corporation had been retired by implementing a Voluntary Retirement Compensation Scheme in July 2016, no officer had been deployed in service for the internal audit of the Corporation during the year under review and no functions whatsoever relating to the internal audit of the Corporation had been performed during the year.

6.3 Procurement and Contract Process

6.3.1 Procurements

The land at Aruwakkalu owned by the Corporation had been handed over to a private company for carrying out a technical study without following the procurement process in terms of the National Procurement Guidelines No.08 of 25 January 2006. A written agreement had not been entered into between the Corporation and the private company regarding this technical study.

6.4 Budgetary Control

Variances ranging from 23 per cent to 229 per cent were observed between the budgeted and the actual expenditure in 09 items of expenditure in the year under review, thus indicating that the budget had not been made use of as an effective instrument of management control.

6.5 Unresolved Audit Paragraphs

The following observations are made.

(a) The loan balance totalling Rs.52,506,824 had not been recovered even by the end of the year under review due to failure in obtaining a security bond in commensurate with the value given on credit basis in awarding the Post of Sales Agent for the sale of cement on credit basis and failure in following a proper and efficient methodology by the Management in granting and collecting of loans.

(b) The land of 06 acres in extent located at Kesbepana, Unawatuna, Galle, purchased at a cost of Rs.1,200,000 by the Corporation had not been made use of for an effective purpose. As such, the Tsunami victims had been resettled therein by the Galle Divisional Secretary. Therefore, a case had been filed by the Corporation in the District Court, Galle for claiming compensation for the said land.

(c) The Aruwakkalu limestone deposit of 5,352 acres in extent located in Puttalum District, owned by the Corporation had been leased out to the Holcim Lanka Ltd, for a period of 50 years by entering into a lease agreement in a manner in which the lease rental cannot be revised. Even though over a period of 06 years had elapsed by providing instructions to revise this lease agreement at the meeting of the Committee on Public Enterprises held on 16 August 2011 at Parliament, action had not been taken by the Management to revise this lease agreement.

(d) The oil storage tank complex located at Kankesanthurai, owned by the Corporation had been handed over for the use of Lanka Petroleum Storage Terminal Ltd. since the year 2010 without entering into a written agreement.

7. Systems and Controls

Weaknesses in systems and controls observed during the course of 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 control.

Areas of Systems and Controls	Observations
(a) Fixed Assets Control	Failure to maintain Registers of Fixed Assets and delay in completing the verification of assets by appointing the Boards of Survey.
(b) Stores Control	Failure in paying proper attention on the maintenance of stocks of cement, storage and maintenance of stock reports.
(c) Internal Control	Failure to introduce methods of internal control and to maintain an internal control by implementing them and non-establishment of an Internal Audit Unit.
(d) Control of Debtors and Creditors	Failure to recover the outstanding loan balances, non-maintenance of records relating to the credit sales and failure to settle creditors by making payments.
(e) Internal Audit	Failure to carry out an internal audit by an Internal Audit Unit.