Kahatagaha Graphite Lanka Limited – 2019/2020

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the Kahatagaha Graphite Lanka Limited "Company" for the year ended 31 March 2020 comprising the statement of financial position as at 31 March 2020 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider, should be report to The Parliament, appear in this report.

In my opinion, except for the effects of the matters described in Paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 March 2020 and of its financial performance and its cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards for Small & Medium Sized Entities.

1.2 Basis for Qualified Opinion

My opinion is qualified on the matters described in Paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards for Small & Medium Sized Entities and for such internal control, as management determine, is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless, the management either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance, are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company.

1.4 Audit Scope (Auditor's Responsibility on Audit of Financial Statement)

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement, resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit is also extended to examine as far as possible, and as far as necessary, the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Company has complied with an applicable written law, or other general or special directions issued by the governing body of the Company;

- Whether the Company has performed according to its powers, functions and duties;

- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Audit Observations on the preparation of Financial Statements

1.5.1 Internal Control over the preparation of financial statements.

Entities are required to "devise and maintain" a system of internal accounting controls sufficient to provide reasonable assurance that, transactions are executed in accordance with management's general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards , and to maintain accountability for assets, access to assets is permitted only in accordance with management's general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

1.5.2 Non-compliance with Sri Lanka Accounting Standards for Small & Medium Sized Entities.

Reference to the Standard and Non-Compliance	Comments of the Management	Recommendation
55 Nos. Fixed Assets Items, amounting to Rs. 5,407,392, which have been depreciated in full, are still in use, as a result of not reviewing the useful life of such assets according to the paragraph 17.19 of Sri Lanka Accounting Standard for Small and Medium-sized Entities, which resulted in an error in accounting estimate, that needs to be reviewed and the correct carrying value be disclosed in Financial Statements as per paragraphs 10.15-10.18 of the Standard.	The necessary actions have been planned in relation to, review the useful life of those Fixed Assets which have been depreciated in full, and to disclose the correct carrying value in the financial statements.	The useful life of Fixed Assets which have been fully depreciated, should be reviewed and correct carrying values should be presented in the financial statements.

1.5.3 Accounting Deficiencies

	Audit Observation	Comments of the Management	Recommendation
a)	The graphite stock as at 31 March 2020 had been derived at by applying cut-off procedure to the stock counted in the month of January 2020. When making the adjustment, sale quantity of 432.32 Metric Tons was taken as 413 Metric Tons and as a result, the Closing Graphite Stock was overstated by 19.32	As pointed out by the Auditors, Quantity Sold had been understated by 19.32 Metric Tons, by mistake, when calculating Cost of Sales and corrections will be done in the financial	Stock Valuation should be accurate.

	Metric Tons which resulted in increase in Closing Stock valuation by Rs. 3,348,926 and the Production Cost (Extraction Cost) has been understated by the same amount.	statements with regard to this.	
b)	A merchandise of Graphite exported in 2017, was found inferior in quality standards for Carbon percentage, which was expected to be between 97 per cent to 99 per cent. The test results were brought to notice after the sales was settled in full and order had been rejected on quality grounds. During the negotiations took place between both parties, a discount of 28,000 USD, was demanded for that sale and the said amount had been deducted from the value of exports made in 2019/20 and the balance had been paid. The 28,000 USD (Rs. 5,003,751) so deducted, had been adjusted to Sales for the year under review, instead of being accounted for as a cash loss.	Because the Company had exported a merchandise with 90/92 carbon percentage in place of 97/99 percentage category, the excess amount of 28,000 USD, they had paid for the sub-standard merchandise, had been deducted from subsequent exports as a sales discount. In, 2019/20 financial year, this amount had been deducted from Sales Income, as a Sales Discount and was entered in Financial Statements. However, the Management has now decided to post this transaction to the accounts in 2020/21 financial year.	Graphite being exported, must be verified for their categories and posting should be made to correct ledgers.
c)	An Interest of Rs.208,926 charged on unpaid Electricity Charges for the year under review, had been included in the Production Cost (Graphite Extraction Cost) and it had been overstated by the Interest Amount.	The management has decided to adjust the Interest charged on the Electricity Bills due to delayed payment, in the accounts for the financial year 2020/21.	Production Cost should be calculated accurately and payments should be made before, interest being charged on delays.
d)	Provision for Gratuity amounting to Rs. 1,331,000 had not been provided for 08 employees, who joined employment from year 2003 to year 2014 and therefore, the ledger balance of Provision for Gratuity had been understated and that of Accumulated Profit had been overstated by that amount.	Calculation of Gratuity for these 08 employees had been missed due to a clerical mistake and adjustment will be made to correct it.	Provision for Gratuity should be adjusted accurately

1.6 Non-Compliance with Laws, Rules, Regulations & Management Decisions

	Reference to Laws, Rules & Regulations etc.	Non-compliance	Comments of the Management	Recommendation
a)	Section 1 Sub Section 4 of Public Enterprise Circular No. 03/2018 dated 07 December 2018	As the Company had a deficit of Rs. 1,418,945 and Rs. 4,399,723 in 2016/17 & 2017/18 respectively, the eligible bonus amount would have been Rs. 3,000 for one employee. However, the Board of Directors had made a decision to pay Rs. 13,500 per employee, aggregated to a total Bonus value of Rs. 1,413,250, which had been paid in the year under review. Therefore, an excess sum of Rs. 996,250 had been paid as Bonus, contrary to the instructions of the Circular.	The employees had lead a strike rejecting the Bonus amounts listed for payment and the Board of Directors had to approve the Bonus for 2019/20, considering the concerns of the employees.	Should comply with the instructions in circulars.
b)	Public Enterprise Circular No. 02/2013 Dated 11 September 2013	The Provision for Gratuity for the year under review, had been Rs. 3,796,539 and a net amount of Rs. 3,111,871 had been invested in line with the provision made. But, on the contrary to the provisions mentioned in the Circular, a sum of Rs.3,287,797 had been withdrawn from it for payment of salaries.	Due to the severe financial difficulties faced by the Company, a sum of Rs. 3,287,797 had been withdrawn from the Gratuity Fund, for the payment of salaries to underground workers, under the restoration basis. The Management of the Company, at present, is taking necessary steps to restore the Fund by making deposits from time to time depending on the financial positions of the Company.	Should comply with the instructions in circulars.
c)	Section 7.4.5 of Public Enterprise Circular No. PED/12 Dated 02 June 2003	Annual Physical Verification of Assets, Inventory Items & Stocks had not been conducted.	Physical Verifications could not be conducted on a timely manner due to Covid-19 Pandemic prevailed in the country and actions are being	Should comply with the instructions in circulars.

			planned for the completion of same.	
d)	Section 40 of the National Audit Act NO. 19 of 2018.	The Management of the Company should have appointed an Internal Auditor within a period not exceeding Two (02) years from the effective date of the Act.	The position of Internal auditor has been approved and the recruitment procedures are being formulated.	Should comply with the instructions of Act.
e)	Paragraph 1(ii) of Management Circular No. 03/2018 Dated 18 July 2018	When the minimum production reaches 65 Metric Tons, a daily incentive of Rs.300 for mine staff and Maintenance workers, and 50 per cent and 40 per cent of the incentive for staff of the Processing Unit and Office had been paid without obtaining the approval from the Department of Management Services.	This Production Incentive Scheme started as a mutual agreement between employer and employee parties under the intervention of Commissioner of Labour – Kurunegala District and has been presented to the Board of Directors for their approval. But due to subsequent disputes arose over certain matters of the agreement, actions are now being taken to formulate a more effective production incentive scheme	Approval should be obtained for Incentives for employees from the Department of Management Services.
f)	The Letter No DMS/11P/C9 Dated 04 October 2007 from The Department of Management Services.	i) It was pointed out that 79 employees, who had been approved for the Company, were initially to be recruited for a contractual period of six (06) months and extending such contracts should be considered, based on the profitability of the Company. However, 59 such employees had been confirmed in employment contrary to the above instructions by the Circular No. 25/2014 Dated 12 November 2014, issued by The Ministry of Public Administration & Home Affairs, which was not	The recruitment Procedure has not yet been approved and the confirmation of these employees had been done under the instructions of the Secretary of the Ministry of Industries according to circular by 25/2014 issued the Ministry of Public Administration and Home Affairs dated 12 of November 2014, having the approval of the Board of Directors of the Company. The Department of Management Services has instructed to rectify this	Should conduct operations as per the given instructions.

applicable for the operation of the Company	error.	
ii) The Recruitment Procedure applicable for Contract Employees, has not yet been approved. There had not been an approved permanent cadre even by the end of the year under review nevertheless the number of available staff, had become 195.	As the necessary actions have not been taken to revise the Permanent Cadre of the Company for a long period, employees, from time to time had been recruited with the approval of the Board of Directors to run and maintain the essential work.	The approval of The Department of Management Services should be obtained for recruitment of staff.

2. Financial Review

2.1 Financial Results

The operating result of the year under review, amounted to a profit of Rs. 9,789,831 and the corresponding loss in the preceding year amounted to Rs.2,849,355. Therefore an improvement amounting to Rs. 12,639,186 of the financial result was observed. The reasons for the improvement have mainly been the overstatement of Closing Stocks by Rs.3,348,926 and a stock write-off, amounting to Rs.8,172,405, included under Finance Expenses in the previous year, which was not observed in the year under review.

3. Operational Review

3.1 Management Inefficiencies

Audit Observation	Comments of the Management	Recommendation
(a) There had no mechanism been established even at the end of the year under review, for achieving higher profits by increasing the value of the final product as well as by attracting a competitive market Production of unsalable Graphite with low carbon percentage had increased from 834 Metric Tons to 925 Metric Tons in 2018 and 2019 respectively.	The Company had to face liquidity problems, as well as stock holding & maintenance issues due to piling up of low carbon graphite in the premises which accounts for 60 per cent of the total production, the total volume of which now has aggregated to around 1000 Metric Tons. As a solution to this, the approval had been taken from The Treasury to purchase and install machines like Forth Flotation and Micron Mill to increase the carbon percentage in Graphite. A Technical committee too had been established and Procurement Procedures are being executed now for the purchase of same.	The profits should be maximized by increasing the value of final product and attracting a competitive market.

(b)	The Price Committee had made a decision in 2019 to increase the price of Graphite by 10 per cent. Even though the remaining quantity is to be supplied in the order made in 2018 by a foreign company, for which, an increase of 5 per cent had been allowed, as price had not been properly negotiated when receiving the order and the said company had not agreed to a 10 per cent increase in the price.	The price Committee normally meets at the end of each year to set prices for the coming year. These New prices are decided upon after having discussions with the buyers and considering prevailing market conditions. As, Sri Lanka is the only commercial source of Natural Crystalline Vein Graphite, a world market price cannot be traced for comparison. However, when setting prices, the final price will be decided considering the prices quoted by our competitive companies.	Providing an indication to the buyer, as to how the annual price increments would take place, or at least, in terms of an approximate percentage of increase which could be expected, should be done when quoting for sales orders.
(c)	No. of Foreign buyers had reduced from 04 to 02 when compared to previous year. One company out of those two buyers had been the sole buyer which contributed to 57 per cent in the previous year and 46 per cent on the year under review, of the total sales volume. On the other hand, a decline was observed in the No. of orders received from buyers, and as the company's export merchandise had not been properly certified by a third party for their quality, the Company had not paid attention to increase foreign exchange income by widening the foreign supply market.	Sri Lanka is the only supplier of Natural Crystalline Vein Graphite in the world main and Kahatagaha and Bogala Mines are the main two suppliers operating in Sri Lanka. There are only a few buyers for this product in the world and the Sri Lanka's supply is merely less than 1per cent in the world market. Therefore, considering the above facts, the Company has made plans to sales existing graphite stocks and to attract new customers and to increase the value of the final products. Floatation of our graphite in association with Ra Gedara Mine, Installation of Forth Floatation and Micron Mill machines, requesting the approval of the Department of Management Services for the Recruitment of a Sales Manager, and calling for bids to sale stocks.	Action should be taken for Obtaining a quality certification for exported graphite, widening the graphite supply market, enhancing the goodwill existing in the world market for graphite.

3.2 Operational Inefficiencies

	Audit Observation	Comments of the Management	Recommendation
(a)	Coconut harvest had been 10,360 and 6,276 nuts in the previous year and in the year under review respectively and there had been a reduction in the harvest by 39 per cent compared to the previous year. However, in the year under review, a sum of Rs. 2,422,950 had been spent for workers in the coconut cultivation and the income received from it, had been around Rs. 241,955and the revenue earned from the coconut harvest is not adequate in relation to the expenses spent on the coconut cultivation.	The coconut cultivation exists in an extent of about 70 acres out of the total extent of 102 acres of the Mining land. 8-12 workers have been employed in the maintenance of the land. About 50 acres of the coconut cultivation consists of old trees where as another 52 acres are subjected to a legal pursuit from which, a restraining order have been issued by the court, restricting any kind of development therein. And also, the dry climate, then existed, too caused the coconut harvest to be reduced. Due to these reasons, manuring of coconut cultivation had been done. Furthermore, sub crops like banana, coffee, cinnamon and pepper have been introduced during this period and the cultivation has been successful now.	The Management should pay attention to the inadequacy of Harvest & Revenue as compared to the expenses incurred.
(b)	As per the Action plan for the financial year 2019/20, the production had been estimated to achieve 609 to 622 Metric Tons whereas, the actual production had been 572.87 Metric Tons, resulting a decline of 159 Metric Tons in the production for the year under review, compared with the production of 732 Metric Tons in the previous year.	Production had been affected by the Covid-19 Pandemic during February & March 2020 and heavy rainfall caused floods in mine, which reduced the production to a zero level. Natural Graphite deposits exist indifferent forms and the excavations have to be done with the development of the mines. The exact locations of these deposits cannot be predicted accurately always and it was observed that, due to these reasons, expected levels had not been achieved.	Necessary actions are to be taken to achieve expected levels in the production.