

Kalubowitiyana Tea Factory Company Limited– 2019/2020

1.1 Qualified Opinion

The audit of the financial statements of the Kalubowitiyana Tea Factory Company 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, profit and loss statement, 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 presented to Parliament appear in this report.

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

1.2 Basis for Qualified Opinion

My opinion is qualified based 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, 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 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 Sub-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.

1.4 Scope of Audit (Auditor's Responsibility for Audit of Financial Statements)

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 scepticism 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 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 to cease to continue as a going concern.
- Evaluate the 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 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 applicable written law, or other general or special directions issued by the governing body of the Company ;
- Whether the it has performed according to its powers, functions and duties; and
- Whether the resources had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Non-compliance with Sri Lanka Accounting Standards

	Non-compliance with Accounting Standards	Comments of the Management	Recommendation
(a)	Even though assets and liabilities shall not be set off unless permitted according to Paragraph 32 of the Sri Lanka Accounting Standard 1, balances receivable amounting to Rs. 186,556 as at 31 March 2020 had been shown in the financial statements by setting off against the balances payable.	Action will be taken to rectify it in future.	Action should be taken in terms of Paragraph 32 of the Sri Lanka Accounting Standard 1.
(b)	Even though inventories shall be measured at the lower of cost and net realizable value in terms of Paragraph 9 of the Sri Lanka Accounting Standard 2, it had not been so done. As such, the closing stock of Made Tea had been overstated in accounts by Rs.7,028,473. Consequently, the profit of the year under review had been overstated by the same amount.	The closing stock has been brought to account on the prudent basis and if it is brought to account at the lower of cost and net realizable value as per the Standard, the net profit of the current year is decreased by Rs.7,028,473. Nevertheless, the net profit of the financial year 2020/2021 is increased by Rs. 7,028,473. Accordingly, the actual final amount has been brought to account as the closing stock.	The stocks should be valued in terms of Paragraph 9 of the Sri Lanka Accounting Standard 2.

- (c) In terms of Sri Lanka Accounting Standard 09, the income tax paid in the year under review should be stated in the preparation of cash flow statement. Nevertheless, the Economic Service Charge of Rs.3,422,829 had been shown in the cash flow statement.
- Since a loss was sustained by the Company in the year 2018/2019, income tax for 2019/2020 had not been paid while the Economic Service Charge paid, has been shown in the cash flow statement. As such, it is correct.
- Action should be taken in terms of the provisions of Standard.
- (d) Even though the lands where the Kalubowitiyana and Derangala Factories valued at Rs.2,550,000 were situated, had been acquired in the year 1994, action had not been taken to revalue and shown them in the financial statements in terms of Paragraph 34 of the Sri Lanka Accounting Standard 16.
- A Valuation Report on the lands where the Kalubowitiyana and Derangala Factories were situated, has not yet been obtained and action will be taken to obtain the Valuation Reports without delay as pointed out by the Audit Report.
- Action should be taken in terms of Paragraph 34 of the Sri Lanka Accounting Standard 16.
- (e) Even though the assets such as plant and equipment, furniture and fittings, office equipment and motor vehicles costing Rs.238,933,334 had been fully depreciated as the useful life of non-current assets had not been reviewed annually in terms of Paragraph 51 of the Sri Lanka Accounting Standard 16, they were being further used. Accordingly, action had not been taken to revise the estimated error and to state the correct carrying amount in the financial statements in terms of Sri Lanka Accounting Standard 08.
- As pointed out by Audit, the Valuation Department has been informed to value the immovable and movable assets owned by the institution. Two reports on the assets of four factories have been submitted. Valuation reports on the assets owned by the Head Office have been obtained and plans have been made for future action.
- Action should be taken in terms of Paragraph 51 of the Sri Lanka Accounting Standard 16 and Sri Lanka Accounting Standard 08.
- (f) In terms of Paragraph 74 (a) of Sri Lanka Accounting Standard 16, the financial statements shall disclose the assets pledged as security. Nevertheless, the land where
- It will be rectified in the ensuing year and action will be taken to disclose the assets pledged as security in the financial statements.
- Action should be taken in terms of Paragraph 749 of the Sri Lanka Accounting Standard 16.

the Kalubowitiyana Tea Factory was situated and pledged as security in obtaining working capital loan of Rs.78,000,000 in the year 2016 by the Company and the fixed deposits of Rs.94,360,821 pledged as security in obtaining bank overdraft, had not been disclosed in the financial statements.

1.5.2 Accounting Deficiencies

Audit Observation	Comments of the Management	Recommendation
(a) Even though the interest income received in the year under review amounted to Rs.11,988,443 , it had been shown as Rs.14,724,355 under the investment activities of the cash flow statement. Moreover, the expenditure for acquiring biological assets had been understated by Rs. 96,917.	The expenditure for acquiring biological assets in the year under review amounted to Rs. 1,918,407. The net value thereof amounting to Rs.1,821,490 had been shown under the investment activities of the cash flow statement. The interest income received in the year under review amounted to Rs. 11,988,443. Accounting for the total interest income of Rs.14,784,355 including the interest of Rs.2,735,912 receivable from the B.C.C. Lanka Company, is correct.	The cash flow statement should be prepared as per the Sri Lanka Accounting Standard 09.
(b) The cost and the cumulative depreciation of the tea dryer disposed at a cost of Rs. 1,000,000 in the year 2014 had not been eliminated from the accounts as at the end of the year under review.	Since there were no adequate documents to find the cost of this tea dryer, it has not been eliminated and as the revaluation of assets has already been completed in this year, the said value will be rectified accordingly.	The cost and accumulated depreciation of the tea dryer disposed should be eliminated from accounts.
(c) According to a judgement of a case filed by an employee against the Company, it had been ordered that a sum of Rs.2,814,705 should be paid by the Company. An appeal	Action will be taken to rectify it in the ensuing year.	The liability which can be arisen for the Company as per the judgement of the case filed against the Company, should be disclosed in accounts.

has been made by the Company and the amount to be paid as per the judgement has been deposited in the Labour Tribunal of Kotapola and shown in the financial statements as deposits receivable. Nevertheless, the liability which can be arisen therefrom had not been disclosed in accounts.

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| <p>(d) Provision for doubtful debts had not been made in respect of trade and other balances receivable amounting to Rs.6,059,340 remained unchanged as at the end of the year under review.</p> | <p>Action will be taken to make provision for doubtful debts in the ensuing year.</p> | <p>Doubtful debts should be made for trade and other balances receivable which remained unchanged.</p> |
| <p>(e) Even though there was no amount payable to the Company from Giragama Estate as per the letters of confirmation of balances of the preceding year and the year under review, a sum of Rs.1,046,771 had been shown as payables from the said Company in the financial statements of the year under review.</p> | <p>It was an advance overpaid for tea leaves supplied to the Menikdiwela Factory. Action will be taken to rectify it in the ensuing year with relevant approvals.</p> | <p>The balances receivable as per the letters of confirmation of balances of the Giragama Estate, should be reconciled and adjusted in financial statements.</p> |
| <p>(f) The balance of Rs.562,644 in Suspense Account which was shown under trade and other debtor balances receivable, had not been settled up to the end of the year under review.</p> | <p>Action will be taken to eliminate these balances from accounts in the ensuing year.</p> | <p>Action should be taken to settle the balance in Suspense Account.</p> |

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Observation

(a) Even though a loan amounting to Rs. 10,000,000 had been granted to the BCC Lanka Limited in the year 2003 at an interest rate of 22 per cent on a recovery basis in 12 installments, it could not be recovered at least one installment. As such, the balance of loan and interest receivable as at the end of the year under review was Rs. 55,646,517.

(b) A sum of Rs.798,461 was receivable to the Company from a private company of tea brokers since the year 2009 and it was not possible to recover it or write off from books on a proper approval even by the end of the year under review.

Comments of the Management

The Department of Public Enterprises had instructed the BCC Lanka Limited to pay the loan granted to them in the year 2003 and interest thereof totalling Rs.55,646,517 at earliest possible. As the 6 acres of lands owned by BCC Lanka Limited has been vested in the Ministry of Prison Reforms, once the amount is received by BCC Lanka Limited, they have pledged in writing to settle this amount to our institution.

Even though requests have been made in writing to the said Company for the recovery of that money, the letters sent have been received to us again. Action will be taken in future to eliminate from accounts on the approval of Board of Directors.

Recommendation

Prompt action should be taken to recover the loan and interest thereof.

Action should be taken to recover the relevant money or to write off from books on a proper approval.

1.6.2 Payable

Audit Observation

Two radiators which should be supplied as per the Conditions of Supply, for the Hydrothermal Power Plant purchased at a cost of Rs.23,414,257 by the Company for the Kalubowitiyana Tea Factory in the year 2014, had not been supplied. As such, the Board of Directors had decided not to make a payment of Rs.1,566,022. Nevertheless, the said balance had been shown as payables in the financial statements.

Comments of the Management

Action will be taken to rectify it in the ensuing year.

Recommendation

Action should be taken enter into an agreement with the relevant party and to rectify the financial statements on the approval of the Board of Directors.

1.7 Non-compliance with Laws, Rules, Regulations, Management Decisions etc.

Reference to Laws, Rules, Regulations, etc.	Non-compliance	Comments of the Management	Recommendation
(a) Public Enterprises Circular No. PED / 12 of 02 June 2003. Paragraph 9.14	Although a procedural manual should be prepared for the formulation of laws and rules on Human Resource Management and obtained the approval of the Secretary to Treasury, the Company had not taken action accordingly.	Action will be taken to prepare a relevant procedural manual for the formulation of laws and rules in respect of Human Resource Management.	A Procedural Manual should be prepared without delay and obtained the relevant approval.
(b) Public Enterprises Circular No. PED 03/2018 of 07 December 2018	Even though a worker can only be paid a bonuses of Rs. 3000 each , only a sum of Rs. 501,000 can be paid as bonuses for employees of companies that have reported a loss in the financial year 2017 and failed to reduce that loss in the financial year 2018, a sum of Rs. 1,665,978 had been paid as bonuses exceeding the relevant limit.	Even though bonuses should be paid as per the Public Enterprises Circular, bonuses totalling Rs.2,166,978 had been paid by the Board of Directors based on the motivation of employees.	Provisions of relevant Circulars should be complied with in the payment of bonuses.

1.8 Financial Management

Audit Observation	Comments of the Management	Recommendation
Overdraft facilities had been obtained by placing fixed deposits as securities to meet the financial requirements of the Company in the year 2015/16 while the overdraft balance of	The bank overdraft had increased gradually with the provision of Rs.50 million to the Tea Shakthi Institute, an expenditure of Rs.41 million incurred for the constructions at Menikdiwela Tea Factory	The Management should take action to maintain the financial position in a proper manner.

Rs.63,067,584 as at the end of that year had increased up to Rs.87,055,800 by the end of the year under review. As such, an interest on overdraft amounting to Rs.13,509,808 had been paid in the year 2019/20 resulting in a negative balance in the net financial income. Accordingly, the Management had failed to maintain the financial position in a proper manner.

and Rs.28 million incurred for the purchase of machinery in the year 2015. Moreover, the loss sustained by the Menikdiwela and Hiniduma Hills factories vested without carrying out a feasibility study has also been a reason for the increase in bank overdraft. Action is being taken to obtain a business financial loan of Rs.50 million at a low interest rate to maintain the financial position in a proper manner.

2. Financial Review

2.1 Financial Results

The operating result of the year under review was a surplus of Rs. 48,196,916 as against the deficit of Rs.50,211,574 for the preceding year. Accordingly, an increase of Rs. 98,408,490 was observed in the financial results. The decrease in cost of sales due to the increase of Rs.62,034,269 in the closing stock of Made Tea of the year under review as compared to the preceding year, had been the main reason for the said increase. Moreover, the decrease in expenditure of sales and distribution by 87.14 per cent has also affected the said result.

3. Operating Review

3.1 Management Inefficiencies

Audit Observation	Comments of the Management	Recommendation
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(a) According to a decision of the Board of Directors of No.KTFL /1419/2019 dated 28 March 2019, an Operating Consultant had been recruited for one year in order to identify the deficiencies in production of Tea in factories functioned under the Company and to convert the current loss-making tea factories to profit-making factories. Nevertheless, no progress was shown in the activities such as obtaining tea leaves, production process, tea auction, local and foreign tea sales etc. which were stated in job specifications. An expenditure of Rs. 1,602,040 had been incurred for the relevant Consultant by the time he left the service after 8 months.	The service of a Consultant has been obtained by the Company on the approval of Board of Directors and the relevant request has been forwarded to the Ministry to seek the Cabinet approval. However, since the Consultant has resigned before the approval was received, his service has not been obtained from November 2019.	Action should be taken to get the functions performed, stated in job specifications, by the officers recruited for specific purposes.

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| <p>(b) The company had granted a loan of Rs. 50 million to the Tea Shakthi Fund in the year 2015 at an interest rate of 11 per cent per year and buildings had been constructed at a cost of Rs.59,532,264 in the Manikdiwela land which was owned by the Tea Shakthi Fund. According to the Cabinet decision No.19/0743/117/024 of 19 March 2019, approval had been granted to vest the ownership of Hiniduma and Menikdiwela Tea Factories to the Company in respect of the loan, relevant interest and the development expenses incurred by the Company. Nevertheless, the ownership had not been vested even by the end of the year under review while the annual interest of Rs. 5,500,000 receivable had also not been brought to account.</p> | <p>According to Cabinet decisions, necessary action is being taken to vest the Hiniduma and Menikdiwela Tea Factories.</p> | <p>According to the Cabinet decision, prompt action should be taken to transfer the ownership of Tea Factories to the Company.</p> |
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3.2 Operating Inefficiencies

Audit Observation	Comments of the Management	Recommendation
<p>(a) According to the criteria of Tea Board, a production level of at least 21.5 kilo grammes of Made Tea should be maintained from 100 kilo grammes of green tea leaves. Nevertheless, the production of 04 factories owned by the Company had not achieved that level during the year under review, thus an uneconomic expenditure of Rs.24,101,145 had been incurred on green tea leaves. Even though a sum of Rs. 1,566,580 had been spent under the concept of Super Tea Leaves to yield green tea leaves of high quality in the year under review, the expected objective could not be achieved.</p>	<p>The percentage of tea leaves of the Tea Factory had declined significantly at present due to the following matters. Failure of tea small holders to pluck tea leaves once in 07 days due to lack of labour , weak level of maintenance work in tea sector due to the high labour cost and since most of the plantations in tea sector were older than 30 years, it has directly affected the weak level of the quality of tea leaves. The increase in percentage of waste tea due to the weak level of quality of tea leaves, is a trend obvious at present. As such, it is difficult to maintain a percentage of 21.5 directly.</p>	<p>Action should be taken to maintain the production level as per the criteria of Tea Board and to look into the other reasons for drop in Made tea, if any and also to take necessary action.</p>

- (b) It was observed that the factories owned by the Company were functioning at a level less than the production capacity in the year under review and Hiniduma and Menikdiwela factories were being underutilized representing 71 per cent and 72 per cent respectively. Sums amounting to Rs.1,531,453 and Rs.1,543,417 had been paid as incentives to suppliers of tea leaves with the intention of increasing the supply for tea leaves at Hiniduma and Derangala Tea Factories during the year under review. Nevertheless, the expected objective had not been achieved.
- A very dry weather prevailed during the period from January 2020 to March 2020 in the area where the factories were located and the tea small holders had stopped the plucking of tea leaves as the tea trees of their lands had dried up. Further, there were significant number of competitive private tea factories in the area and incentives ranging from Rs.5 to Rs.15 were being given to the tea small holders through various methods and thereby, tea leaves were being provided to the said factories. Under the circumstances, the factory has obtained a significant quantity of tea leaves due to these incentives.
- Action should be taken to utilize the production capacity of factories.
- (c) Hiniduma and Derangala Tea Factories owned by the Company, had paid advances amounting to Rs.891,681 and Rs.220,464 respectively to the suppliers of tea leaves before supplying tea leaves. Nevertheless, the suppliers had not supplied tea leaves, thus said balances could not be recovered by the end of the year under review.
- Letters of Demand have been sent to the relevant persons through a Lawyer and action will be taken in future to recover the said money.
- Action should be taken without delay to recover the money paid as advances to the suppliers of tea leaves.
- (d) A sum of Rs.966,860 had been spent on the Carnival, “*Nuwara Eliya Wasantha Udanaya*” and other trade fairs in April 2019 with the intention of increasing the local sales income. Nevertheless, sales income of the year under review had decreased by Rs.10,577,492 as compared with the preceding year. Incurring of such expenditure had not contributed to increase the local tea sale income of sales centre.
- The price of a tea packet had been revised in August 2019 and thereby, the price has increased while the sales income has dropped. Moreover, the price was reduced in July 2020, after being revised again.
- When incurring promotion expenditure, attention should be paid to effective promotion strategies.