

Kahatagaha Graphite Lanka Limited -2020/2021

1. Financial Statements

1.1 Qualified Opinion

The audit of financial statements of the Kahatagaha Graphite Lanka Limited ‘Company’ for the year ended 31 March 2021 comprising the Statement of financial position as at 31 March 2021 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year 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 reported 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 accompanying financial statements give a true and fair view of the financial position of the Company as at 31 March 2021 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 the Qualified Opinion

My opinion is qualified based on 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 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 Size 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 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, it 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 Scope of Audit (Responsibility of Auditor regarding the 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 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 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 Company has performed according to its powers, functions and duties; and
- 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 Non- compliance with Sri Lanka Accounting Standards for Small & Medium Sized Entities

Reference to the Standard and Non-Compliance	Comment of the Management	Recommendation
The non-current assets amounting by Rs.7,131,924 which have been fully depreciated are still being used, 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 amount be disclosed in Financial Statements as per paragraphs 10.15 – 10.18 of the Standard.	Due to the corona pandemic situation of the country, it was delayed to estimate the correct fair value of the fixed assets and it has been decided to do this in future.	The useful life time of the fully depreciated non-current assets should be reviewed and correct carrying amount should be presented in the financial statements.

1.5.2 Accounting Defeciencies

Audit observation	Management Comments	Recommendation
(a) A sales invoice of USD 39,270 was accounted for as USD 42,018. Due to debiting of foreign exchange profit and loss accounts instead of debiting sales account to correct the overstatement of sales value, the sales income was overstated by US Dollar 2748 or Rs.584,491 and the balance of foreign exchange profit and loss account was under stated in the year under review.	The related sales invoice was issued as USD 39270 but the CUSDEC paper issued by the Sri Lanka ports Authourity stated the value as USD 42019 including the 7 percent royalty to be charged from the buyer. Generally, the value mentioned in the CUSDEC sheet is considered for VAT and accounting purposes. So the value mentioned in it has been accounted for	Correct sales value should be accounted for

- | | | | |
|-----|--|--|--|
| (b) | A sum of Rs. US Dollar 44,159 had been received against a receivable of US Dollars 42,019 including 7 percent royalty on export of graphite. The balance of royalty account was reduced by Rs.310,334 as the excess amount of US Dollars 2140 was credited to the royalty account without identifying which expenses it was for reimbursement. | The excess US Dollars 2140 was received for special pallets requested by the buyer and this amount was erroneously credited to the royalty account. The management has decided to correct this mistake in the next year. | Receipts and reimbursement of expenses should be accurately identified and properly accounted for. |
| (c) | No provision was made for the royalty payable of Rs.972,185 to the Geological Survey & Mines Bureau for an export during the year under review. | Royalty expenses has been incurred in the month of April 2021 for the relevant export invoice and the expenditure has been included in the accounts for the year 2021/22 on a cash basis | Proper provision should be made for payables. |
| (d) | The balance of the foreign exchange gain /loss account was overstated due to the receipt of Rs.687,457 which had not been recognized as receivables relating to the accounting year 2019/2020 had been accounted for the foreign exchange gain /loss account during the year under review. | Royalty paying as Rupees in case of reimbursement of buyers receives as US dollars and the difference in foreign exchange rate between the two dates is accounted for in exchange gain/loss account. Management has decided to reconcile this fact in future accounts. | Royalty received for the year 2019/2020 should be adjusted to the retained earnings. |
| (e) | The closing stock of the year under review was calculated on the basis of production and sales data. The closing stock was over calculated by Rs.3,373,316 since a sale of 20 metrictons was considered as 1 metricton. | Processing accounts are prepared for costing requirement and manufacturing cost is calculated to primary cost. Management has decided to correct the mistake of stating a sale of 20 MT as 1 MT in the next preparation of accounts. | Closing stocks and cost should be accurately calculated and accounted for |
| (f) | Amounting to Rs.96,841 and Rs.710,168 were to be paid as contributions to the Employees Trust fund and Employees provided Fund respectively for the month of March 2021. But, due to incorrect adjustment of the opening balance payable, the balance payable as at the end of the year under review was shown in the financial statements as Rs.24,112 and Rs.766,170 respectively. | The closing balance of the employees provident fund and employees trust fund have changed due to unrecognized balance that have been there for a long time. Management has decided to rectify this in future preparation of accounts. | Error adjustments in the opening balances should be identified and corrected. |

- (g) Interest of Rs.1,353,892 charged on electricity bills in the year under review was included as a direct cost of graphite mining. As a result the direct cost of graphite mining was overstated from that amount.
- Due to severe financial difficulties during the current year, it was not able to pay the electricity bills on time and it has been decided to correct the mistake of including the realized interest in production cost in next year.
- Expenses should be identified correctly and accounted for and action should be taken to rectify the error.

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

Reference to the Laws, Rules and Regulations etc	Non-compliance	Management Comment	Recommendation
Paragraph 3.5 of the Public Enterprises Circular No 02/2013 dated 11 september 2013.	Although an amount of Rs.16,881,328 was identified as the amount of gratuity to be paid on 31 March 2021, the balance of the gratuity investment fund was Rs.10,664,290. Accordingly, an under investment of Rs.6,217,038 had been made.	Due to severe financial difficulties in the institution, it was difficult to invest in the gratuity investment fund at once and actions had been taken by depositing money in parts to increase the fund upto Rs.21,579,451 by November 2022.	The gratuity provision should be invested in accordance with the instructions of the circular.

2. Financial Review

2.1 Financial Results

The operating results of the year under review amounted to a profit of Rs.15,992,349 and the corresponding profit in the preceding year amounted to Rs.4,885,445. Therefore an improvement amounting to Rs.11,106,904 of the financial result was observed. Decrease in Sales and Distribution expenses by Rs.5,068,125 Personal Cost by Rs.4,442,329 and Establishment & Administration cost by Rs.1,279,442 was the main reasons for the improvement.

3. Operational Review

3.1 Management Inefficiencies

Audit observation	Management Comments	Recommendation
(a) The price committee meeting on October 2020 had approved to increase the price of US Dollar 1963.50 to US dollar 2063.50 per metriton of KL 97-99 type graphite which was exported to a company. However, in the year 2021, the company deprived an income of US Dollar 4000 nearly Rs.792,000 due to not charging the revised price for 40 metric tons of graphite exported to the said company.	The price committee increased the selling price of graphite to First Graphite Company from USD 1963.5 to USD 2063.5 on 20 October 2020, But because the buyer rejected the new price, it was sold at the same price on the verbal instructions of the Secretary of the Ministry.	When making management decisions the ability of their implementation should be considered.

- | | | | |
|-----|---|---|--|
| (b) | The company was sued in years 2004 and 2007 by two outside parties claiming rights over two blocks of land 26.5 acres and 6 acres belonging to the Kahatagaha mine. Even so, the proceedings were not settled by the audited date of 01 December 2022. Also, 11 people including three people who worked in the mine are living illegally in quarters located in an area of 8 roods and 87 perches within the mining areas, and although efforts have been made at the Ministerial level to evict the illegal residents who have been resident illegally have not been able to evict even by December 2022. | Legal officers of the Ministry are working in this regard. It cannot be satisfied that quantitative measures have been taken regarding the acquisition of land belonging to the institution and the possession of other properties. | Urgent steps should be taken to settle the property owned by the company. |
| (c) | According to the letter of the Secretary of the Ministry of Policy Formulation and Implementation dated 15 October 2003, the board of directors had decided on 16 October 2003 to provide the necessary space for the Dodamgaslanda youth crops training center from the land belonging to the Kahatagaha Mine. Accordingly, the land was released in the year 2003 for a period of 3 years and as of the date of audit, that period has exceeded 16 years, but the land is being used without entering into a lease agreement or paying rent. | According to the lease agreement, the management had not taken action to value the asset and recover the lease value and even the buildings belonging to our company were removed and all the properties on that land were being processed by the relevant company. | Steps must be taken to agree with the relevant parties to enter into a lease agreement and to act according to the agreement, and to collect the arrears of lease rent. |
| (d) | The need for a second shaft from the first 1130 feet level to the 2000 feet level of the mine was recognized a few years ago and preliminary work was started, but further work was not done. Also the national building research organization had issued a report that walking through the current used traditional winch is dangerous. | The start of second shaft was postponed due to the corona situation and the work has been made difficult due to the shortage of explosive. However, it is planned to start the work in 2023. | Steps should be taken to expand operational activities and avoid hazardous situations as per plan. |
| (e) | An incentive of Rs.300 per day was paid to the underground workers and Rs.120 per day to the processing sector and office workers when the monthly production was 65 metric tons or more without the approval of the treasury. While paying the incentives, the payment was added to the monthly salary as a fixed allowance without checking the achievement of the monthly target | Currently, it has been suggested that the production incentive should be revised to benefit both the organization and the employees. Accordingly, new another production incentive scheme has been approved and activities are being carried out | Employees are not entitled to production incentives paid without achieving the desired level of performance, so those payments must be recovered. Steps should be taken to implement a suitable incentive scheme |

production. However it was observed that the company did not achieve the expected performance through the production incentive as the production was in the range of 57 metric tons to 18 metric tons during the period from January to December 2021. to implement it from the year 2023. with relevant approvals.

3.2 Operational Inefficiencies

Audit observation	Management Comments	Recommendation
(a) At the end of each year, the graphite stock that consisted of low-carbon graphite was growing to 834 metric tones, 925 metric tones and 1098 metric tones in the years 2018/2019, 2019/2020 and 2020/2021 respectively. Also as a solutions to the fact that a higher percentage of the total graphite stock consists of low-carbon graphite, a floating machine was purchased, and with the help of it, it was expected to increase the carbon percentage of low – carbon graphite and increase the income, but it was not implemented by December 2022.	About 16 million have been approved by the national budget for the company in 2023 and plans are being made to build the floating machine.	Actions should be taken to promote oprations as per plans.
(b) Due to the export of 440 metric tons of graphite by the company in the year 2020/21 in the form of raw materials without value addition, the purpose of creating manufacturing industries that use and process graphite locally and thereby creating a strong market locally as a task of the company as started in the annual performance report has not been to fulfilled.	A value addition procedure is currently in place to process and export graphite extracted from the ground. To improve it, it is planned to install a micron mill machine in the year 2023 and for that, from the year 2023 Rs. 16 million have been approved from the national budget. Concessions such as one month credit period are provided for sale of graphite to local manufacturers. At present, the relevant institutions have not taken steps to bring foreign investments into the country to obtain new technology and to provide infrastructure as necessary measures to establish industries that use graphite locally in sri lanka.	Establish achievable goals and take necessary steps to achieve them as planned.

- | | | | |
|-----|---|---|---|
| (c) | <p>While the company is supposed to follow international tendering process in selecting customers for its sales, annually or once in some specified period, such a system was not followed till the year under review and two foreign buyers had acquired the total exports of the company. As a result, it was observed that measures were not taken to find new buyers to get a higher price for graphite by creating competition among foreign buyers.</p> | <p>The demand for Sri Lanka crystal graphite in the world market is very low and a Japanese company acts as the main buyer for low carbon graphite. A price committee attached to the ministry determines the sales price of graphite annually and all graphite export activities are carried out based on those prices. In the discussion held at the ministerial level to follow the tender procedure related to graphite sales, it was decided that while maintaining the existing price committee system and should try to follow the tender procedure and make sales. The reason for this was that the graphite should be prepared and made into a finished product according to the buyers requirement and it is not possible to keep the graphite prepared without demand.</p> | <p>A formal tender process should be followed to select customer for sales.</p> |
|-----|---|---|---|

3.3 Human Resources Management

Audit Observation

Although approval was not given for the permanent recruitment of the skilled and unskilled mine workers, On the contrary 36 were recruited under permanent and 07 temporary workers were recruited as excess.

Management Comments

The existing approved staff was only approved for a period of 6 months during the opening of the mine in 2007 and although it was requested to the management services department to increase it in many cases, the approval has not been given so far. The board of directors had approved the new recruitment as they were not sufficient in running the mine.

Recommendation

The staff should be approved and the employees should recruit accordingly.