

Transaction report of the Milco (Private) Limited - 2023

The audit of the operational activities of the Milco (Private) Limited for the years ended 31 December 2023 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. This report contains my observations on the operations of the company for the year 2023, which I intend to submit to the Parliament in accordance with Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Responsibilities of Management and those charged with governance for the financial statements

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 its income, expenditure, assets and liabilities to enable annual and periodic financial statements to be prepared of the entity.

According to the Section 16(2) of the said Act, the annual financial statements in respect of each audited entity, should be submitted by the Chief Accounting Officer to the Auditor General along with the annual performance reports within such period as may be prescribed by the rules.

In terms of section 38 (1) (d) of the said Act, the Chief Accounting Officer should ensure the timely preparation and submission of annual reports and other financial statements and in addition he is required to submit annual reports to Parliament pertaining to the entity.

2. Financial Statements

2.1 Presentation of financial Statements

Audit Observation	Comments of the management	Recommendation
As per paragraph 6.6 of the Operations Manual submitted with the Public Enterprises Circular 01/2021 dated 16 November 2021, Although the financial statements and draft annual reports for the years 2022 and 2023 had to be submitted to the Auditor General within 60 days of the end of the accounting year, the financial statements and draft annual reports for the years 2022 and 2023 had not been submitted to the Auditor General by 20 November 2024.	It is accepted that there has been some delay in the preparation of the financial statements, but the financial statements for the year 2022 have been prepared and are scheduled to be submitted to audit after obtaining the relevant approval of the Board of Directors The financial statements for the year 2023 are currently being prepared.	Financial statements and draft annual reports must be prepared and submitted to the Auditor General.

3. Financial Review

3.1. Profit and loss situation of factories

	Audit Observation			Comments of the management	Recommendation
	Out of the 05 factories under the company, 04 factories in Digana, Ambewela, Colombo and Polonnaruwa manufacture dairy products while the Polgahawela factory manufactures animal feed. The profit and loss situations of the factories are as follows.				
Factory	2021	2022	2023		
	(Rs)	(Rs)	(Rs)		
		(As per draft financial statements)			
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Ambewela	(84,540,671)	344,160,692	405,754,087		
polonnaruwa	336,334,916	(169,271,616)	166,785,984		
Digana	(55,533,416)	(514,941,217)	(69,804,663)		
Colombo	242,872,200	(304,129,608)	76,527,488		

- (a) The Polonnaruwa and Colombo dairy factories of the company had reported a profitable situation in 2021, but in 2022, both factories had reported a significant loss. Although it had grown back to a profitable position in 2023, the profitability achieved had decreased by 50 and 68 percent respectively compared to 2021.
- Losses at the Polonnaruwa, Digana and Colombo factories have increased significantly compared to 2021. The main reason for this is that due to the economic recession in the country in 2022, the prices of raw materials, packaging materials, and other services and materials increased daily, resulting in a significant increase in production costs, and no action was
- Actions should be taken to increase the profitability of the institution.

taken to increase the prices of goods in proportion to the increased production costs. Furthermore, as there was a continuous decrease in the number of liters of milk purchased from farmers, it resulted in a decrease in the production capacity of the institution, which affected the profitability of the institution in these years.

- (b) The Digana Dairy Factory had continuously reported losses in the years 2021, 2022 and 2023, and the management had not taken steps to investigate the reasons for that situation and make the factory profitable.

This was mainly due to the increase in production costs due to the increase in raw material prices, the failure to increase commodity prices in proportion to this, and the decrease in milk production by farmers. The main factors contributing to losses in this factory should be studied and actions should be taken to increase profitability.

3.2. Ratio Analysis

	Audit observation				Comments of the management	Recommendation
	The accounting ratios calculated for the four years from 2018 to 2021, as per the financial statements submitted by the company, are shown below.					
Ratio	2018	2019	2020	2021		
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Current ratio	1.35	1.091	1.52	1.99		
Quick assets ratio	0.67	0.62	0.79	0.89		
Gross profit ratio	1.95%	3.84%	12.62%	9.48%		
Net profit ratio	(5.88)%	(8.36)%	2.03%	0.275%		
Debt collection period	28days	27days	22days	15days		
(a)	It was observed that although the company's current ratio and quick ratio had increased from 2018 to 2021, they were not at optimal levels. Accordingly, it is observed that the Board has a working capital problem.				No comments were made.	The working capital requirements of the institution must be maintained optimally.
(b)	Although the gross profit ratio had increased from 2018 to 2020, it had decreased by 25 percent in 2021, and although the net profit ratio had shown a positive situation in 2020, it had again decreased by 86 percent in 2021. Accordingly, it was observed that the company's profit and loss position was constantly fluctuating.				The gross profit margin and net profit margin have decreased due to the increase in production costs and the lack of a corresponding increase in product prices.	Actions should be made to increase the profitability of the institution.
(c)	Although there was a significant positive trend in the collection period of debtors, a slow trend was observed in the collection of balances over five years.				No comments were made	Actions should be taken to recover outstanding debts.

4. Operational Review

4.1 Performance

4.1.1 Planning

Audit Observation	Comments of the management	Recommendation
(a) In accordance with the Public Finance Circular No. 01/2014 and dated 17 February 2014, an action plan should be prepared based on the corporate plan, including the commercial activities expected to be implemented in the coming financial year, and it should include the annual budget, proposed major investments, capacity expansions, annual procurement plan including major procurements, human resource development plan and internal audit plan, etc. However, the action plan prepared by the company for the year 2023 did not include the above information and only included information on targeted programs.	Although the Human Resources Development Plan, Internal Audit Plan and Annual Budget had been prepared for the year 2023, those reports had not been included in the Action Plan.	The action plan should be prepared by including the human resource development plan, internal audit plan, and annual budget.
(b) The company had failed to achieve the expected physical progress in the digitalization of milk acceptance activities, construction of a cold storage facility at the Digana factory, completion of preliminary work for the second phase of the wastewater treatment plant at the Ambewela factory, and renovation of the machine shop building at the Polonnaruwa factory, which the company had planned to accomplish in the year 2023.	Due to the difficulty in allocating the necessary financial provisions and the decision taken by the Cabinet to restructure the institution in the middle of the year, the expected physical targets of those projects, which included capital expenditures, could not be achieved.	Attention should be paid to completing tasks as planned.
(c) There were 19 programs planned to be completed in 2023, of which 7 programs had achieved physical progress of less than 50 percent, while the physical progress achieved in the activities of opening the company's farms, renovating the old butter factory floor at the Ambewela factory, and preparing and implementing an effective marketing plan was 10 percent. The physical progress achieved in the planned automation of the invoice and sales distribution system was 5 percent.	Due to financial difficulties during the year, decisions taken by management from time to time, and the order of priority given, it was difficult to implement some of the programs that had been planned.	Attention should be paid to completing tasks as planned.

- (d) In accordance with paragraph 4.2.1.(b) of the Procurement Guidelines, the Company shall prepare a Master Procurement Plan for a period of at least three years and thereafter, the Board shall prepare a regularly updated Procurement Plan for the procurement activities for the coming year, including the matters specified in paragraph 4.2.1 of the Procurement Guidelines, within a period not exceeding six months from the Master Procurement Plan. Although a procurement plan including such matters had not been prepared for the year 2023.
- Action will be done to prepare a procurement plan for the coming years.
- Actions should be taken to prepare the procurement plan in accordance with the Procurement Guidelines.

4.2. Operational inefficiencies

Audit Observation	Comments of the management	Recommendation
(a) According to the regional distribution of raw milk collection, a decrease of 7,831,666 liters was observed in raw milk collection in the 9 regions except the Nuwaraeliya region in 2023 compared to the year 2022, while raw milk collection in all regional regions in 2022 decreased by 20,408,863 liters compared to the year 2021.	The decrease in milk in 2022 compared to 2021 was due to the entry of competitive milk collectors into the dairy industry and their purchase of milk without regard to its quality. Also, the decline in milk in 2023 compared to 2022 was primarily due to the failure of Milco to increase milk prices at the right time compared to other competitors.	A formal procedure should be implemented to purchase the raw milk required for production.
(b) According to the company's production progress in the years 2021, 2022 and 2023, a decrease was observed in products other than pasteurized milk, cow's milk and cheese in 2022 compared to 2021, while the production of liquid milk, yogurt and vegetable oil decreased in 2023 compared to 2022.	Production also decreased in proportion to the decrease in the addition of raw milk, the basic ingredient for products.	Necessary action should be taken to increase production.

- (c) According to the company's sales progress in the years 2021, 2022 and 2023, a decrease in sales of UHT milk, sterilized milk, yogurt, ice cream, vegetable oil, cheese, butter, milk powder and condensed milk was observed in 2022 compared to 2021, while sales of products other than cow's milk, ice cream, cheese and milk powder decreased rapidly in 2023 compared to 2022.
- Sales volumes also decreased relative to production.
- Necessary measures should be taken to increase production and sales.
- (d) Although it is essential to purchase a significant amount of milk from the country's total milk production, the main input required to produce the desired product in order to achieve the desired market share, the company's purchase of milk for its production activities remained at a minimum level of 9 percent, 13 percent and 8 percent in 2021, 2022 and 2023.
- No comments were made.
- A formal procedure should be implemented to purchase the raw milk required for production.

	2021	2022	2023
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Expected amount of liquid milk (liters)	96,551,000	66,629,000	59,342,000
Liquid milk collections by company (liters)	67,905,259	47,496,397	39,775,076
Total liquid milk production (liters) according to the Department of Census and Statistics	513,305,478	506,449,602	504,153,360
Collection progress as % of total liquid milk production	13.22	9.38	7.9

- i. The amount of liquid milk collected by the company had gradually decreased from 2021 to 2023, and the decrease in 2023 compared to 2022 was 7,721,321 liters or 16.2 percent.
- The decrease in milk in 2022 compared to 2021 was due to the entry of competitive milk collectors into the dairy industry and their purchase
- A formal procedure should be implemented to purchase the raw milk required for

- of milk without regard to production.
its quality. Also, the decline in milk in 2023 compared to 2022 was primarily due to the failure of Milco to increase milk prices at the right time compared to other competitors.
- ii. The percentage of liquid milk collected by the company as a percentage of the total liquid milk production in the island is very low and that percentage had gradually decreased from 2021 to 2023. In 2022, that percentage was 9.38 percent, and in 2023, it had decreased to 7.9 percent.
- The decline in milk in 2023 compared to 2022 was primarily due to the failure of Milco to increase milk prices at the right time compared to other competitors.
- A formal procedure should be implemented to purchase the raw milk required for production.
- (e) In 2021, the actual liquid milk sales volume was 20,705,024 liters, in 2022, the liquid milk sales volume was 16,012,534 liters, and in 2023, the liquid milk sales volume was 13,258,335 liters, indicating a gradual decrease in liquid milk sales. Although the current market trend is towards liquid milk consumption, management has not focused on increasing liquid milk production.
- Liquid milk production also decreased in proportion to the decrease in total milk production.
- A formal program should be implemented to increase sales.
- (f) A contract was signed with a foreign construction company in 2015 for the establishment of the Badalgama Milk Processing Factory at a contract value of Rs. 9,718,217,432 (EUR 63,935,641) and was scheduled to be completed in 2019. However, due to the inability to complete the project within the relevant period, the factory has not yet commenced operations. Furthermore, since the transformer built to supply electricity to the factory had to be kept operational 24 hours a day, the factory had incurred a significant monthly cost for electricity even though production activities were not taking place, and a total electricity cost of Rs.12,079,005 had been incurred from February 2022 to June 2024, the period during which construction was suspended. It was about 2/3 of the factory's monthly electricity costs. Also, a monthly cost of over Rs.200,000 had to be incurred for security purposes. The security and electricity costs incurred had become a non-
- To carry out the work of this project, 3-phase electricity is obtained through a transformer. During the period of work on this project, the entire electricity bill was paid by Desmi Construction A/S. Although this project is currently on hold, our company will pay the electricity bills for our engineers as they will be using the official residences and buildings of this project. With a focus on the security of the machinery and buildings here, a private security firm has been hired to
- The responsible parties should pay attention to completing the construction work promptly and starting production.

economic expense due to the failure to make the necessary arrangements to commence operations promptly.

provide security services for this project. We have been bearing the security costs even while this project was in progress and will continue to bear these costs as long as the project continues.

- (g) Among the construction of the new Badalgama dairy factory, the administration and office building on 24 March 2021, the official residence of the factory general manager and 04 senior official residences on 15 December 2021, and 05 junior official residences on 22 January 2020 handed over to milco and the construction work of the factory was halted midway by June 2023. Although two or three workers were deployed for cleaning activities from June 2023 to October 2023, no workers had been deployed for cleaning activities until 4 July 2024, the date of the physical inspection of the factory. On the day of the physical inspection, it was observed that due to the lack of proper maintenance in all the houses except the administrative and office buildings, weeds and vines had grown even inside them, becoming habitats for various insects and animals such as rats, and that the furniture in some houses had been damaged.

The Badalgama Dairy Factory Project is a project being carried out under the "TURNKEY" methodology and the projects carried out under this methodology will be controlled by the company authorized to construct it until the entire project is completed and handed over to the relevant owners. Accordingly, the entire work of this project will be carried out by Desmi Construction A/S. Work on this project has been temporarily halted due to the suspension of foreign loan payments following the Central Bank of Sri Lanka declaring our country a bankrupt state on 12.04.2022 on behalf of the Government of Sri Lanka. We have also informed the current government about this situation, but we have not been informed of an official decision on how to proceed in this regard. Due to this, cleaning and other activities in the constructed buildings are not being carried out at this time. However, we have paid for these buildings and houses to be

Responsible parties should pay attention to the completion of construction work and should also pay attention to the maintenance and proper upkeep of the constructed buildings.

cleaned from time to time on a daily basis. It should be noted that these activities will continue in the future.

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| <p>(h) The UPS system connected to the main electrical circuit of the dairy building included in the Badalgama Milk Processing Factory had been completed for more than 4 years by the year 2024. More than 100 batteries had been included in the system to obtain electricity and as the life of those batteries had expired by the audit date of 01 July 2024, the batteries had to be replaced before the factory could start operations and for this, a cost of more than Rs.60,000 would have to be incurred for each battery, and accordingly, it was observed that a cost of approximately Rs.6,000,000 would have to be incurred for this.</p> | <p>The UPS system batteries for the main electrical circuit of the dairy building have been installed for almost 4 years now. Although there is a possibility that its electrical charging capacity may have decreased by now, if there is an opportunity to install new UPS system batteries at the time of commencement of this project, Milco and Desmi Construction will work together accordingly.</p> | <p>Action should be taken to minimize additional costs incurred through the prompt completion of construction work.</p> |
| <p>(i) The batteries in the 02 generators installed in the factory had also reached the end of their service life. As a result, it was observed that these batteries would also need to be replaced before the factory could resume operations, at a cost of over Rs.100,000 per battery, resulting in a total cost of over Rs.400,000.</p> | <p>Although the rechargeable batteries in the two generators installed at the Badalgama factory have now reached the end of their service life, once the work on this project commences, the installation of these new batteries will be carried out in conjunction with Milco and Desmi Construction, as required.</p> | <p>Action should be taken to minimize additional costs incurred through the prompt completion of construction work.</p> |

4.3 Management Inefficiencies

Audit Observation	Comments of the management	Recommendation
<p>(a) According to the survey plan No. 4754 conducted on 10 March 1980, the government-owned land on which the Ambewela factory is located is 40 acres 01 rood 36 perches and the company has carried out construction and installations worth</p>	<p>Although a lease has been granted for this, the lease agreements have not been signed. The Ministry has forwarded the relevant requests to the Commissioner General of</p>	<p>Action should be taken to acquire ownership of the lands.</p>

Rs.5,548 million on it, but the company had not taken steps to take over the ownership of this land until 31 December 2023.

Lands to take over the ownership of the land, and they should carry out these activities. Also, since the Cabinet has taken a decision to restructure the Milco Institute, the acquisition of the ownership of the land has been temporarily suspended.

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| (b) | The company owns two lands, the 12-acre land where the Polonnaruwa Dairy Factory is located and another 37 acres. However, even by the end of 2023, the company did not have the deeds and plans related to these two lands. | This is government-owned land. Only the tenure of this land has been transferred to Milco. The government should transfer the full ownership of these lands to Milco. The plans of these lands have been found and are in the possession of the company. | Action should be taken to acquire ownership of the lands. |
| (c) | The total outstanding balance of the Ambewela, Digana and Polonnaruwa factories owned by the company over 05 years was Rs. 9,313,290 and it was observed that the recovery of this outstanding balance was in an uncertain state. | These balances include long-term non-moving balances and the process of obtaining relevant approvals to remove those balances from the accounts is currently underway. | Action should be taken to recover outstanding debts or, if they cannot be recovered, to obtain the necessary approvals and remove them from the accounts. |
| (d) | As of 31 December 2023, the value of the payable creditor balance of the company's head office over 05 years was Rs.11,198,640, including a debit balance of Rs.4,141,873. Furthermore, a time analysis had not been submitted in relation to the payable creditor balance of Rs.4,591,120 at the Ambewela factory. | These balances include long-term non-moving balances and the process of obtaining relevant approvals to remove these balances from the accounts is currently underway. These accounting errors will be corrected in the next years through the relevant corrections. | Action should be taken to pay the amounts due or, failing that, to obtain the necessary approvals and remove them from the accounts. |
| (e) | Physical verification had not been carried out on fixed assets for the year 2023 as of 24 November 2024, and since the company does not maintain a properly maintained fixed asset register, it was not possible to verify the accuracy of the cost, existence, depreciation calculations, cost of assets removed, etc. of fixed assets. | Plans are underway for a revaluation based on a physical verification of assets. | A formal record should be maintained regarding fixed assets and action should be taken to revalue and account for them correctly. |

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| (e) | The sterilized milk bottle manufacturing machine at the Digana Dairy Factory, which cost Rs.9,500,000, and the ice cream container manufacturing machine at the Colombo Dairy Factory, which cost Rs.15,445,587, were at a minimum underutilization level of 46 percent and 71 percent respectively. | The production of sterilized milk bottles also decreased in proportion to the decrease in total milk production. Also, due to inflation in the country, the demand for ice cream decreased, and ice cream production had to be limited in proportion to this. | Relevant measures should be taken to promote product sales and work should be done to increase production accordingly. |
| (f) | Although the total capacity of the old and new production plants of the Ambewela Dairy Factory is 9,300,000 liters, according to the information submitted for audit in the years 2021, 2022 and 2023, the average capacity utilization was 2,675,819 liters, 1,497,295 liters and 1,092,820 liters respectively, which was 29 percent, 16 percent and 12 percent of the total capacity respectively. | Production also decreased in proportion to the decrease in raw milk collection. | A formal program should be developed to collect raw milk and action should be taken to increase production. |

4.4. Human Resource Management

	Audit Observation	Comments of the Management	Recommendation																					
	The approved staff of the company for the year 2023 was 1578 and the actual staff as on 31 December 2023 was 1242. The details are as follows.																							
	<table border="0" style="margin-left: auto; margin-right: auto;"> <tr> <td style="padding-right: 20px;">Approved</td> <td style="padding-right: 20px;">Actual</td> <td>Vacant</td> </tr> <tr> <td style="padding-right: 20px;">Senior</td> <td style="padding-right: 20px;">80</td> <td>63</td> </tr> <tr> <td style="padding-right: 20px;">tertiary</td> <td style="padding-right: 20px;">133</td> <td>118</td> </tr> <tr> <td style="padding-right: 20px;">Secondary</td> <td style="padding-right: 20px;">529</td> <td>394</td> </tr> <tr> <td></td> <td style="padding-right: 20px;"><u>836</u></td> <td><u>667</u></td> </tr> <tr> <td style="padding-right: 20px;">Primary</td> <td></td> <td></td> </tr> <tr> <td></td> <td style="padding-right: 20px;"><u>1578</u></td> <td><u>1242</u></td> </tr> </table>	Approved	Actual	Vacant	Senior	80	63	tertiary	133	118	Secondary	529	394		<u>836</u>	<u>667</u>	Primary				<u>1578</u>	<u>1242</u>		
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(a)	There were 80 senior level approved posts for the year 2023, and the number of actual officers was 63, leaving 17 posts vacant. Of those posts, arrangements had not been made to recruit for the posts of Deputy General Manager, Planning and Operations	Following the government's decision to impose restrictions on the recruitment of employees and the subsequent restructuring of Milco, the recruitment of employees has	Necessary steps should be taken to fill the vacancies.																					

- Manager, and Research and Development Assistant Manager. Also, although the number of approved officers for the post of Project and Engineering Manager was 01, two officers had been recruited for it on a permanent basis.
- been suspended. Accordingly, officers have been appointed to perform duties for the approved posts. Furthermore, a Manager has been recruited for the Innovation and Development Division based on the internal service requirement, and since it has not been approved by the Department of Management Services, he has been included in the approved post of Assistant Manager - Projects and Engineering.
- (b) Although the approved number of employees for the posts of Engineer, Dairy Development and Procurement Officer, Planning and Operations Officer and Quality Assurance Officer at the tertiary level of the company is 07, 02, 10 and 01 respectively, the actual number of employees is 10, 03, 12 and 02. It was observed that 03, 01, 02 and 01 employees are working in excess in those posts and no action had been taken to obtain approval from the Department of Management Services for those posts.
- It was observed that a tendency of officers resigning within a short period of time due to service requirements was observed, and that excess staff had been recruited and that the surplus employees had now been deployed in other productive tasks.
- Action should be taken to formally obtain the necessary approvals for employee recruitment from the Department of Management Services.
- (c) Recruitment had not been made for the 2 tertiary level posts of Information Technology Officer and Quantity Surveyor in the approved staff of the company and the primary level post of Motor Electrician as of 31 December 2023. Furthermore, although the approved number of employees for the post of Electrician, which is a primary level post, is 22, 25 employees had been recruited for it on a permanent basis and one employee had also been recruited on a temporary basis.
- Four surplus employees (including one employee recruited on a probationary basis) are on duty for the posts of electricians. This recruitment has been done based on the need for the service. However, new recruitments have not been made for the posts of electricians.
- The necessary approvals for employee recruitment should be obtained from the Department of Management Services and recruitment activities should be carried out.

5. Accountability and Good Governance

5.1 Budgetary Control

Audit Observation	Comments of the Management	Recommendation
In accordance with the Public Enterprise Circular 1/2021 dated 16 November 2021, a budget should be prepared and submitted along with the action plan for the year 2023, including realistic income and expenses covering both recurrent and capital aspects, taking into account internal and external factors, and budgeted income and expenditure statements, a balance sheet and a cash flow statement, as applicable to the annual accounting format, but the company had not submitted a budget document accordingly.	Although a budgeted income and expenditure statement had been prepared for the year 2023, it had not been included in the action plan.	Action should be taken in accordance with the provisions of the circular.

5.2 Achieving Sustainable Development Goals

Audit Observation	Comments of the Management	Recommendation
The United Nations had introduced the Sustainable Development Agenda based on the goal of achieving economic growth, social development and environmental protection in all member countries by the year 2030, and accordingly, five goals were identified under three expected objectives. In achieving the Sustainable Development Goals, progress on two goals established in 2023 had not been achieved as planned.	The Small Scale Agribusiness Participation Program, in association with Milco, is planned to implement a program to develop the productivity of 3,000 dairy farmers covering the Uva, Central, Northwestern and North Central provinces until 2025. By the end of 2023, 17% of the total project, including the installation of a UPS machine to provide continuous power supply at the Ambewela factory, is to be completed.	Action should be taken to complete the relevant tasks as planned.