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Special Audit Report on the Import of Rice by the Lanka Sathosa Ltd. (Lanka Sathosa) during the years 2014 and 2015

Background for the issue of the above Report and the Nature of the Report

This Report is issued in accordance with the request made by the Committee on Public Enterprises to the Auditor General at the Meeting of the Committee on the Co-operative Wholesale Establishment and the Lanka Sathosa Ltd., held at 1430 hours on 20 September 2016, to examine the import of rice by the Lanka Sathosa during the years 2014 and 2015 and forward a Report thereon to the Committee. (Annexe 01)

2. The Audit Methodologies followed in the preparation of this Report

The following methodologies were followed.

2.1 Examination of Registers, Books and Records

- (a) Report of the Five Member Committee appointed by the Secretary to the Ministry of Industry and Commerce on 16 October 2015 to examine the rice in the stores of the Lanka Sathosa.
- (b) The Report of the Committee appointed by the Chairman of the Lanka Sathosa on 19 October 2015 to examine the imported rice of the Lanka Sathosa.
- (c) The data on the annual production of paddy and rice of Sri Lanka included in the Annual Reports presented by the Central Bank of Sri Lanka.
- (d) The data on the rice requirements, the annual production and rice imports of Sri Lanka obtained from the Socio-economic and Planning Division of the Department of Agriculture.
- (e) Information obtained from the Ministry of Industry and Commerce.

- (f) Information obtained from the different Departments of the General Treasury.
- (g) Information, data and files relating to the import of rice obtained from the Lanka Sathosa.
- (h) Information on the sealing of stores of imported rice obtained from the Public Health Inspectors.
- (i) Information and data on the import of rice during the years 2012, 2013, 2014 and 2015 obtained from the Sri Lanka Customs.
- (j) Information obtained from the Paddy Marketing Board.
- (k) Information obtained from the Department of Co-operative Development.
- (l) Information on rent of stores obtained from the Department of Food Commissioner.
- (m) Information on loans obtained from the Bank of Ceylon and the People's Bank.

2.2 Other Examinations

- (a) Physical examination of the stores at Meethotamulla, Veyangoda, McCallum and Ekala where imported rice had been stored.
- (b) Physical examination of the rice contained in the containers retained on rent basis at the ACE Container Yard.
- (c) Written Statements obtained from the officers of the Lanka Sathosa and the Public Health Inspectors.

3. Limitation of Scope

It is emphasized that my scope in relation to the issue of this report, was subjected to the following limitations.

- (a) Inability / lack of an occasion to conduct a direct audit of the Lanka Sathosa until the Auditor General received the mandate to conduct the audits of State Companies from the Nineteenth Amendment to the Constitution of the Democratic Socialist Republic of Sri Lanka.
- (b) The existence of a period of 2 years approximately between the subject event which commenced in the year 2014 and the date on which the Auditor General was requested to carry out an examination of the process.
- (c) The obstructions that existed in carrying out an examination of the stocks of rice.
 - (i) The failure on the part of the Lanka Sathosa to carry out physical count of stock of rice.
 - (ii) The failure to maintain proper stock records of rice stores.
 - (iii) The failure to arrange the storage of rice methodically to facilitate easy physical examination / computation.
 - (iv) Most of the rice stocks available at the Meethotamulla, Veyangoda, McCallum and Ekala Stores at the time of stores inspection being damaged beyond inspection.
 - (v) Lack of a documented / computerized formal methodology for obtaining the information on stocks at each store and at the institution.
- (d) The failure on the part of the Ministry of Industry and Commerce and the Lanka Sathosa to supply the information required for audit as set out in Annexe 02.
- (e) Inordinate delays in the supply of the information required for audit as set out in Annexe 03, by the Ministry of Industry and Commerce and the Lanka Sathosa.

- (f) Difficulty / delay / inability in obtaining the information as most of the officers in the higher management level and the other staff of the Institution in service during the years 2014 and 2015 in which rice was imported, have already left the institution at present.
- (g) The existence of large scale weaknesses in the systems and methodologies for the maintenance of accounts and information of the institution.
- (h) The information, registers and files of the Lanka Sathosa being removed by the following institutions in connection with the investigations on the import of rice and the failure on the part of the Lanka Sathosa to retain photocopies of certain files and documents.
 - (i) Presidential Commission of Inquiry (Investigation of Serious Frauds, Corruption and Misuse of Public Property, Privileges, Power and Authority).
 - (ii) Financial Crimes Investigation Division.
 - (iii) Commission for Investigation of Allegations of Bribery or Corruption.

4. General Matters

4.1 Incorporation of the Company

The Lanka Sathosa Company incorporated on 26 October 2005 under the Companies Act, No. 17 of 1982 had been re-registered on 19 March 2010 under the Companies Act, No. 07 of 2007. The issued capital of the Company amounted to Rs.893,752,720 and according to the Form 06 on the issue of shares furnished by the Chairman of the Lanka Sathosa to the Registrar General of Companies on 19 August 2014, the composition of the shares had been as follows. (Annexe 04)

Share Ownership	Number of Shares	Value	Percentage
-----	-----	-----	-----
	-	(Rs.)	
Secretary to the Treasury	87,095,381	870,953,810	97.44
Co-operative Wholesale Establishment	2,279,884	22,798,840	2.55
Board of Directors	7	70	0.000001

4.2 Objectives of the Company

The Primary Objectives of the Company as appearing in the Articles of Association are as follows. (Annexe 05)

- (i) To carry on the business of selling offering for sale and distributing essential goods of every description and other commodities to the consumer public.
- (ii) To ensure that essential commodities are available to be purchased by the consumer public from retail outlets of the company at affordable prices.

- (iii) To commence, establish, manage and carry on business as exporters and importers of and as wholesale and retail dealers and traders of consumable and other goods of any description. Such business as purchasers and collectors of goods shall be restricted to goods that are not so purchased and collected at the relevant point of time by the Cooperative Wholesale Establishment (C.W.E.)
- (iv) To carry on the business of purchaser, collector, processor, stores, packers, distributors, sellers and suppliers of agricultural produce, Consumable and other goods of every description. Such business as purchasers and collectors of goods shall be restricted to goods that are not so purchased and collected at the relevant point of time by the cooperative wholesale Establishment (C.W.E)
- (v) To establish by way of outright purchase, lease or rent storage and trading facilities and to sell, lease, hire and market warehouse, trading and storage space and facilities.
- (vi) To provide by way of contract the services of skilled and unskilled labour and other human resources to business and other private enterprises.
- (vii) To provide services of whatever description to the consumer public.
- (viii) To ensure the viability and business and commercial sustainability of the company by engaging in businesses authorized herein, other than by the retail trading of essential commodities, which business shall be engaged in by the company with the primary objective of providing a service to the consumer public.

4.3 Composition of the Board of Directors

According to the Article of Association of the Company, the Board of Directors should comprise 11 members. Nevertheless, only 07 members had been appointed to the current Board of Directors. The Commissioner of Co-operative Development, who is a permanent ex-officio member of the Board of Directors had withdrawn from the Board of Directors on 11 November 2015 and 03 members to be nominated by the relevant Minister had not been appointed. Information on the Board of Directors from the year 2006 to date is given below.

Name	Post in the Board of Directors	Date of Appointment	Date of Withdrawal
-----	-----	-----	-----
1. Mr.K.N.R.Fernando	Director / Chairman	2006.12.01	2015.01.21
2. Mr.Krishantha Kapuwatta	Director	2010.05.31	2015.02.06
3. Mr.D.Jeevanadan	Director	2010.06.30	2015.11.11
4. Mr.Chamila Jayan Munasighe	Director	2010.07.01	2015.01.07
5. Mr.N.M.D.Nawaratne	Director	2010.07.19	2015.05.25
6. Mr.D.Ajith P.Abeyssekara	Director	2011.12.21	2015.01.20
7. Mr.W.H.Karunaratne	Director	2012.01.16	2014.06.30
8. Mr.D.D.Upul Shantha de Alwis	Director	2014.07.01	2015.07.15
9. Mr.Kasimir Kiran Atapattu	Director / Chairman	2015.01.28	2015.08.03
10. Mrs.S.Senaratne	Director	2015.02.27	2015.08.03
11. Mr.A.U.M.Yaseer	Director	2015.02.27	Current Member
12. Mr.M.H.M.Haddad	Director	2015.03.24	2016.09.10
13. Dr.R.M.K.Ratnayake	Director	2015.05.25	2015.11.16
14. Mr.M.H.M.Zafrash	Director	2015.06.08	Current Member
15. Mr.Sameera T.Jayawardena	Director	2015.06.11	2015.07.28
16. Mr.G.A.Ajith Priyantha	Director	2015.06.11	2015.07.28
17. Mr.W.A.Dhammika Rajapaksha	Director	2015.07.15	2015.10.08
18. Mr.Sena Sreenath Meeyanawala	Director / Acting Chairman	2015.08.03	2015.09.15
19. Mr.M.Rizwan Hameem	Director	2015.10.13	Current Member
20. Dr.Rohantha Athukorala	Director / Chairman	2015.11.20	Current Chairman
21. Mr.R.Rushandan	Director	2015.12.01	Current Member
22. Mr.A.P.Kurumbalapitiya	Director	2015.12.01	Current Member
23. Mrs.R.A.Indika Ranathunga	Director	2015.12.29	Current Member

4.4 Staff Information

Information on the staff of the Company as at 31 May 2016 is given below.

Particulars	Approved Staff	Actual Staff	Vacancies	Excess
Higher Management Level	14	10	4	-
Middle Management Level	23	11	12	-
Junior Management Level	31	24	7	-
Management Assistant	578	438	140	-
Primary Level	2,429	2,842	-	413
Total	3,075	3,325	163	413

4.5 Paddy Production in Sri Lanka, Supply of Local and Imported Rice and Rice Consumption

(In '000 Metric Tons)

Year	Paddy Production		Total Paddy Production	Local Rice Production *	Imported Rice	Total Rice Supply	Rice Consumption
	Yala	Maha					
2015	2,877	1,942	4,819	3,369	286	3,655	2,438
2014	2,236	1,145	3,381	2,364	600	2,964	2,404
2013	2,846	1,774	4,620	3,231	23	3,254	2,382
2012	2,717	1,129	3,846	2,895	36	2,931	2,364
2011	1,996	1,898	3,894	2,723	28	2,751	2,427

* Local rice production is computed at 0.7 metric ton of rice per metric ton of paddy.

(Source of Data : Data of the Annual Reports of the Central Bank of Sri Lanka and the information obtained from the Letter No. SEPC/STAT/AMD/IT (DOA) dated 17 November 2016 of the Director of Socio – economic and Planning Centre of the Department of Agriculture.)

4.6 Information on the Importation of Rice by the Private Sector and the Public Sector during the years 2012 to 2015

Year	Private Sector	Public Sector			Total
		Lanka Sathosa	Ministry of Economic Development	Other Institutions of the Public Sector	
2015	118,856	167,265	-	553	286,674
2014	504,525	90,294	1,150	5,007	600,976
2013	21,896	-	1,093	60	23,049
2012	26,508	-	9,732	-	36,240
Total	671,785	257,559	11,975	5,620	946,939

(Source of Data : Data System of the Sri Lanka Customs)

4.7 The Manner of the Purchase of Rice by the Lanka Sathosa

The Lanka Sathosa had purchased rice in the years 2014 and 2015 as shown below.

Manner of Purchase -----	Quantity (Metric Tons) -----	Cost, Insurance, Freight (CIF) Value (Rs.) -----
i. Purchase of locally produced Rice	46,668	2,688,941,911
ii. Imported Rice purchased from the Local Market	18,134	1,199,495,609
iii. Direct Purchase of Rice from the Foreign Market on Document Against Payment System	29,262	1,851,055,933
iv. Direct Purchase by Lanka Sathosa from Foreign Market through Letter of Credit	1,040	62,634,808
v. Purchases from the Foreign Market on the approval of the Cabinet of Ministers	75,002	4,347,942,373
vi. Purchase of Rice from the Foreign Market with the concurrence of the General Treasury	152,255	9,734,901,658
Total	322,361 =====	19,884,972,292 =====

4.8 Monthly Sales of Imported Rice of Lanka Sathosa

The Chairman of the Lanka Sathosa had, by his unnumbered letter dated 28 November 2016, informed that the information on the Monthly Sales of Rice could not be supplied due to the following reasons. (Annexe 06)

- (a) Even though the Lanka Sathosa has established 321 Sales Outlets Island-wide, 220 Sales Outlets out those had not been linked to the Computer network.
- (b) As the sales information of the 220 Sales Outlets not linked to the computer network are entered into the computer network classified under 05 major sales groups, the sale of rice cannot be separately identified.

4.9 Rice Stocks of the Lanka Sathosa

The following stocks of rice were available as at the last date of each month of the years 2014 and 2015.

Year	Month	Quantity of Monthly Stock (Metric Tons)				Number of Months for which the stock of Rice is adequate
		Ponni Samba	Nadu	White Rice	Total	
-----	-----	-----	-----	-----	-----	-----
2014	January					
	February					
	March					
	April					
	May					
	June					
	July					
	August					
	September					
	October					
	November	5,435	8,943	32,153	46,531	
	December	2,878	9,800	37,820	50,498	
2015	January	1,016	19,347	37,646	58,009	
	February	27,203	24,971	30,176	82,350	
	March	23,680	28,604	33,362	85,646	
	April	7,828	14,804	30,427	53,059	
	May	27,462	11,856	26,969	66,287	
	June	37,278	14,495	23,625	75,398	
	July	35,255	11,546	21,032	67,833	
	August	35,794	10,387	18,782	64,963	
	September	51,028	9,352	16,523	76,903	
	October	50,719	7,830	13,323	71,872	
	November	46,847	(29,239)	10,468	28,076	
	December	56,470	3,472	6,977	66,919	

- * As the Lanka Sathosa had not furnished the information on the stocks of rice relating to the period from January to October 2014 and on the monthly sales of the years 2014 and 2015, the number of months for which the stocks at the end of each month will be sufficient could not be completed.
- * The above information does not include the stocks of rice with 321 Sales Outlets.
- * Recording of the balance stock of Nadu Rice as at the end of November 2015 as a deficiency of 29,239 metric tons is a questionable issue.
- * It is not possible to be satisfied in audit with regard to the accuracy of the above stocks due to the reasons such as obtaining the stocks available in the stores from the Storekeepers by telephone, the failure to maintain the stock records in a proper manner and the non-conduct of physical verification of stocks.

5. Examination of the Rice Imports by the Lanka Sathosa during the years 2014 and 2015

According to the information made available to Audit, 257,559 metric tons of rice costing Rs.15,996,534,772 had been imported in the years 2014 and 2015 from India and Bangladesh through opening of Letters of Credit and under the Documents Against Payment System. In addition to the above, 18,134 metric tons of imported rice valued at Rs.1,199,495,609 had also been purchased from the local market.

Documents Against Payment System or Letter of Credit No.	Date of Opening of Letter of Credit	Letter of Credit Value (US\$)	Variety of Rice	Supplier	Quantity Received (Metric Tons)	CIF Value (Rs.)	CIF Value per Kilogram (Rs.)	Supply of Funds
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1. Local Purchase

Local Purchase of Imported Rice				14 Suppliers	18,134	1,199,495,609		Lanka Sathosa
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2. Direct Import of Rice by the Lanka Sathosa

Documents Against Payment (DP)			Nadu and Samba Rice	07 Suppliers	29,262	1,851,055,933		Lanka Sathosa
42002140026193	2014.09.22	455,000	Nadu Rice	Omvishkar Exports	1,040	62,634,808	60.23	People's Bank

3. Import of Rice from the Foreign Market under the Approval of the Cabinet of Ministers

42002140024186	2014.09.01	21,500,000	White Rice	United Foods (pvt) Ltd	50,002	2,843,606,997	56.87	People's Bank
BTD-M 064568	2014.12.10	11,250,000	Nadu Rice	Government of Bangladesh	25,000	1,504,335,376	60.17	Bank of Ceylon

4. Import of Rice from the Foreign Market on Concurrence of the General Treasury

BTD-M 63519	2014.10.29	1,994,018	Nadu Rice	ACP Industries Ltd	4,887	268,319,420	54.90	Bank of Ceylon
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BTD-M 63519 (Extension)	2015.02.17	18,056,000	Ponni Samba Rice	ACP Industries Ltd	37,704	2,500,017,885	66.31	Bank of Ceylon
BTD-M 63537	2014.10.30	2,403,837	Ponni Samba Rice	ACP Industries Ltd	4,926	323,514,220	65.68	Bank of Ceylon
BTD-M 63537 (Extension)	2015.02.13	21,996,163	Ponni Samba Rice	ACP Industries Ltd	43,384	2,861,893,578	65.97	Bank of Ceylon
42002140033283	2014.12.03	12,150,000	White Rice	United Foods (Pvt)Ltd	30,000	1,630,038,846	54.33	People's Bank
42002140033274	2014.12.03	15,300,000	Ponni Samba Rice	Trident Chemphar Ltd	31,354	2,151,117,709	68.61	People's Bank
Total					275,693	17,196,030,381		

The observations on each purchase of rice shown above are given below.

5.1 Purchase of 18,134 Metric Tons of Imported Rice from the Local Market

The Lanka Sathosa had purchased 18,134 metric tons of imported rice valued at Rs.1,199,495,609 from 22 April 2014 to 12 December 2014 from 14 suppliers in the Local Market. (Annexe 07)

The observations in this connection are given below.

- (a) Even though the quantity of imported rice purchased from the local market, according to the letter dated 11 November 2016 of the Manager - Purchase / Procurement (Spices) of the Lanka Sathosa amounted to 18,134 metric tons valued at Rs.1,199,495,609 , according to the Report of the Committee for Investigation of Imported Rice appointed by the Chairman of the Lanka Sathosa, 27,072 metric tons of rice valued at Rs.1,457,866,378 had been purchased by the Lanka Sathosa from the local market. Accordingly, a difference of 8,938 metric tons of rice existed. (Annexes 08 and 09)

- (b) In view of the unavailability of an approved Procurement Procedure of the Lanka Sathosa and the institution being a State Company, it should have followed the provisions in the Government Procurement Guidelines of the NPA Circular No. 08 of 25 January 2006 in the purchase of imported rice from the local market. Contrary to that, 14 suppliers referred to above had been selected without following any procurement procedure whatsoever. (Annexe 10)
- (c) In terms of Guideline 8.9.1 (b) of the Government Procurement Guidelines, a formal contract should be signed for any supply of goods or services exceeding Rs.500,000. Nevertheless, the Lanka Sathosa had not entered into contracts with the 14 suppliers in the above purchase of rice valued at Rs.1,199,495,609. (Annexe 11)
- (d) Rice had to be purchased from the suppliers at different prices as the 14 suppliers had been selected without following a procurement procedure as referred to above.

5.2 Import of 29,262 Metric Tons of Rice under Documents Against Payment System

The Lanka Sathosa had imported stocks of rice totalling 29,262 metric tons valued at Rs.1,851,055,933 (U.S.\$ 13,949,070) comprising 14,739 metric tons of Ponni Samba Rice valued at Rs.1,000,181,682 (US\$ 7,538,520) and 14,523 metric tons of Nadu Rice valued at Rs.850,874,251 (US\$ 6,410,550) from 07 Indian Suppliers in 21 instances during the period from 10 April 2014 to 29 December 2014 under the Documents Against Payment for sale through its network of Sales Outlets (Annexe 12)

The observations in this connection are given below.

- (a) There was no evidence in support that the approvals of the Board of Directors had been obtained for the purchase of rice under the Documents Against Payment and in all 21 instances, the Deputy General Manager (Procurement) had made endorsements on the Pro-forma Invoices that **“the Chairman has given instructions for the import of rice”**. Examples appear in Annexe 13.
- (b) The provisions in the Government Procurement Guidelines, as referred to in paragraph 5.1(b) above, had not been followed in the selection of these 07 suppliers as well. (Annexe 10)
- (c) As referred to in paragraph 5.1(c) above, the Lanka Sathosa had not entered into contracts with the 07 suppliers in the above purchase of rice valued at Rs.1,851,055,933. (Annexe 11)
- (d) As such, due to the failure to follow a procurement procedure in the import of rice, purchases had been made at different prices per metric ton in the 21 instances of import from 10 April 2014 to 29 December 2014 resulting in abnormal price variances as shown below. (Annexe 12)
 - (i) Purchase of 14,739 metric tons of Ponni Samba Rice had been made in 12 instances and the price per metric ton of that rice had been in the ranges from US\$ 440 to US\$ 535, or Rs.58.08 to Rs.70.62 per kilogramme.
 - (ii) Purchase of 14,523 metric tons of Nadu Rice had been made in 09 instances and the price per metric ton of that rice had been in the ranges of US\$ 385 to US\$ 460 or Rs.50.82 to Rs.60.72 per kilogramme.

5.3 **Import of 50,000 Metric Tons of Rice on the Approval of the Cabinet of Ministers No. 14/0940/540/005 of 31 July 2014**

According to the Cabinet Memorandum No. 14/0940/540/005 dated 09 July 2014 presented by the then Minister of Co-operatives and Internal Trade stating the need for **“Maintaining a Buffer Stock for Food Security and Stabilising the Price of Rice in the Market”** and expected the approval of the Cabinet of Ministers for the following proposals. (Annexe 14)

- (i) Import of 50,000 metric tons of rice by the Co-operative Wholesale Establishment (CWE).
- (ii) This stock of rice should be securely maintained as a buffer stock by using the stores system belonging to the Department of Food Commissioner by renewing every six months.
- (iii) The cost in this connection to be obtained from the General Treasury.

The approval for the proposals of that Cabinet Memorandum had been granted as follows at the Meeting of the Cabinet of Ministers held on 31 July 2014. (Annexe 15)

- (i) Lak Sathosa should import the rice in parts of 5,000 metric tons each and take action to sell those through its network of Sales Outlets.
- (ii) If it is necessary to maintain a stabilised price of rice during the festival season from November to January, maintenance of a buffer stock of rice for a period of 2 months for issue to the market by using the stores facilities belonging to the Department of Food Commissioner.
- (iii) The funds required for this purpose to be managed within the short term credit limit approved for the Lak Sathosa.

Accordingly, an order for 50,000 metric tons of white rice had been made on the Indian Company named United Foods Ltd. through the letter of Credit No. 42002140024186 dated 01 September 2014 issued by the People's Bank and 50,002 metric tons valued at Rs.2,843,606,997 had been received during the period from 17 September 2014 to 16 November 2014. (Annexes 16, 17 and 18)

The observations in this connection are given below.

- (a) An examination of the Cabinet Memorandum presented and the approval of the Cabinet of Ministers revealed the following matters.
 - (i) The variety of rice to be imported had not been specifically stated.
 - (ii) The buffer stock of rice needed for the period of 2 months had not been determined.
 - (iii) Even though approval had been sought for the import of rice by the Co-operative Wholesale Establishment (CWE), import of rice by the Lak Sathosa had been approved.
- (b) Even though the approval had been granted for the import in parts of 5,000 metric tons, contrary to that approval, a single order had been placed for 50,000 metric tons of rice. As such the stock of rice had been received during a short period of 60 days from 17 September 2014 to 16 November 2014 (Annexe 18)
- (c) Even though approval had been granted for the maintenance of a buffer stock of rice by using the stores belonging to the Department of Food Commissioner and instead of importing at the rate of 5,000 metric tons in terms of the approval of the Cabinet of Ministers, the import of 50,000 metric tons in one lot, it had become necessary for using a store of the private sector situated at Ekala in addition to the stores of the Department of Food Commissioner.

- (d) The provisions in the Government Procurement Guidelines, as referred to in paragraph 5.1(b) above, had not been followed in the selection of this supplier as well. (Annexe 10)
- (e) As referred to in paragraph 5.1(c) above, the Lanka Sathosa had not entered into a contract with the supplier in the purchase of the above rice valued at Rs.2,843,606,997. (Annexe 11)
- (f) The Chairman had, by his unnumbered letter dated 20 February 2015, informed the Director General of the Department of Management Audit that the Ministry of Co-operatives and Internal Trade had nominated and sent the above supplier. (Annexe 19)
- (g) In a situation where Samba and Nadu Rice is locally consumed to a large extent, there was no evidence whether a market study was carried out to select white rice as the variety of rice to be imported.
- (h) Even though the achievement of the objectives such as stabilization of price of rice in the market, supply of rice without causing a scarcity and the maintenance of a buffer stock for use in times of emergency was expected by presenting the Cabinet Memorandum, there was no evidence to support whether such objectives were achieved from the import of 50,000 metric tons of white rice.
- (i) Even though the Lanka Sathosa had placed orders for 13,300 metric tons of Ponni Samba and Nadu Rice by using its funds under the Documents Against Payment System and received a quantity of 3,349 metric tons of that rice even by 01 September 2014, on which date the Letter of Credit for the import of the above stock of rice was opened, it was not observed that attention had been paid to the above situation, in the opening of the Letter of Credit for the import of 50,000 metric tons of rice on the approval of the Cabinet of Ministers (Annexes 20 and 21)

(j) The Minister of Finance and Planning and the Minister of Construction, Engineering Services, Housing and Common Amenities had submitted the following observations on the Cabinet Memorandum No. 14/0940/540/005 dated 09 July 2014 submitted by the Minister of Co-operatives and Internal Trade, to discourage the importation of the rice referred to above. (Annexes 22 and 23)

(i) Observations of the Minister of Finance and Planning

- i. The price of rice in the local market has already stabilized as the rice importers in the private sector are importing rice at present in view of the removal of the Special Commodities Levy by the Notification published in the Gazette Extraordinary No. 1857/10 of 09 April 2014 in consideration of the possible scarcity of rice in the local market.
- ii. The possibility of an increase of the price of rice supply in the foreign market if 50,000 metric tons of rice is imported in one consignment.

(ii) Observations of the Minister of Construction, Engineering Services, Housing and Common Amenities

- i. Large stocks of rice had to be sold as animal feed due to lack of facilities for secure storage of rice.
- ii. A financial loss would be caused to the Government through the importation of 50,000 metric tons of rice and long term storage.
- iii. The private sector has already imported about 120,000 metric tons of rice since reducing the duty imposed allowing for the free importation and that the imports will further increase up to November, according to the trends in the importation.

- iv. As the harvesting of paddy of the Yala Season in areas such as Akkaraipattu has already started, the farmers will be distressed due to falling price of rice resulting from the importation of rice.

5.4 Import of 1,040 Metric Tons of Nadu Rice on the Letter of Credit No. 42002140026193

The Lanka Sathosa had imported 1,040 metric tons of Nadu Rice valued at Rs.62,634,808 from the Indian Company named Omwishkar Exports by opening the Letter of Credit No. 42002140026193 dated 22 September 2014 through the People's Bank by using its own funds. The entire stock of this rice had been received by the Lanka Sathosa on 23 October 2014. (Annexes 24 and 25)

The observations in this connection appear below.

- (a) The provisions in the Government Procurement Guidelines, as referred to in paragraph 5.1 (b) above had not been followed in the selection of this supplier as well. (Annexe 10)
- (b) As referred to in paragraph 5.1(c) above, the Lanka Sathosa had not entered into a contract with the supplier in the purchase of the above rice valued at Rs.62,634,808. (Annexe 11)
- (c) Even though the Lanka Sathosa had imported stocks of 64,800 metric tons of rice as at 22 September 2014 by using its own funds under the Documents Against Payment System and on the approval of the Cabinet of Ministers a further stock of 1,000 metric tons of Nadu Rice had been imported without considering that position (Annexe 20)

5.5 Import of 90,901 Metric Tons of Rice through Letters of Credit No. BTD-M63519 and No. BTD-M63537

The Deputy Secretary to the Treasury had, by his letter No. DFD/RICE/LS-2014 of 15 October 2014, informed the Chairman of the Lanka Sathosa that the Indian Company named ACP Industries Ltd. had agreed to supply 50,000 metric tons of Ponni Samba Rice and 50,000 metric tons of Nadu Rice, to take immediate steps for the import of that rice and action will be taken for making the Bank of Ceylon to make available the Banking facilities required in this connection. Accordingly, the Treasury had made the arrangements of facilities for the opening of 02 Letters of Credit No. BTD-M 63519 and No. BTD-M 63537 by the Bank of Ceylon for the import of this stock of rice. (Annexes 26, 27 and 28)

The observations in this connection appear below.

- (a) Even though the Indian Company named the ACP Industries Ltd, had addressed its letter No. ACP/201314/Oct/Export/002 dated 01 September 2014 expressing its consent to supply 100,000 metric tons of rice, to the then Minister of Economic Development, any matters whatsoever for expressing such consent direct to a Minister were not revealed. (Annexe 29)
- (b) Even though the Deputy Secretary to the Treasury had, by his letter No. DFD/RICE/LS-2014 of 15 October 2014, informed the Chairman of the Lanka Sathosa to take immediate steps for the purchase of 100,000 metric tons of rice from the ACP Industries Ltd. there was no approval granted by the Cabinet of Ministers in that connection. (Annexe 26)

- (c) Despite informing the Chairman of Lanka Sathosa by his letter dated 15 October 2014 for the purchase of 100,000 metric tons of rice, 02 days thereafter, that is, on 17 October 2014, the Deputy Secretary to the Treasury had placed an order on the above Indian Company by his letter No. DFD/Rice/In/Acp dated 17 October 2014 for the purchase of Ponni Samba Rice at US\$ 488 per metric ton and Nadu Rice at US\$ 408 per metric ton (totalling 100,000 metric tons) . (Annexe 30)
- (d) Two days prior to submitting the letter of the Deputy Secretary to the Treasury dated 15 October 2014 instructing to take immediate action for the purchase of 100,000 metric tons of rice to Board of Directors of the Lanka Sathosa on 19 October 2014, that is, on 17 October 2014, the Deputy Secretary to the Treasury had placed an order for the stock of rice. (Annexe 31)
- (e) The provisions in the Government Procurement Guidelines, as referred to in paragraph 5.1(b) above, had not been followed in the selection of the supplier as well. (Annexe 10)
- (f) As referred to in paragraph 5.1(c) above, the Lanka Sathosa had not entered into contract with the supplier in the above purchase of rice valued at Rs. 5,953,745,103. (Annexe 11)
- (g) The Secretary to the Ministry of Industry and Commerce had, by his letter No. CIT/6/8/Import/Rice dated 11 March 2015, informed the Director General of Management Audit that **“the Indian Company named ACP Industries from which rice was imported had been nominated and sent by the Treasury, that the Ministry Procurement Committee or the Technical Evaluation Committee for the importation activities of the Lanka Sathosa had not been appointed”**. (Annexe 32)

- (h) The total quantity of rice imported by the Lanka Sathosa by using its own funds and on the approval of the Cabinet of Ministers by 15 October 2014, the date on which the Deputy Secretary to the Treasury issued instructions to the Chairman of the Lanka Sathosa to import a quantity of 100,000 metric tons of rice, had been 91,210 metric tons. Out of the stock of rice so ordered, 57,086 metric tons of rice had been received by 29 and 30 October 2014, the date on which the two Letters of Credit were opened for the import of the rice referred to above. (Annexes 20 and 21)
- (i) Even though the letter dated 17 October 2014, through which the Deputy Secretary to the Treasury had placed orders for rice, informed the Indian Company that the entire stocks of rice (100,000 metric tons) should be supplied before 31 December 2014, only 4,926 metric tons of Ponni Samba Rice and 4,887 metric tons of Nadu Rice had been received even by 20 February 2015, the date on which the two Letters of Credit expired. (Annexes 30 and 33)
- (j) The Indian Company had, by its letter No. ACP/Exports/2015/02/011 of 09 February 2015, requested the Chairman of Lanka Sathosa to further extend the period of the Letters of Credit for shipping of the balance stocks of rice as it was not possible to ship the rice before the expiry of the period of the above Letters of Credit. (Annexe 34)
- (k) At the meeting held on 12 February 2015 under the Chairmanship of the Minister of Industry and Commerce to discuss the position with regard to the stocks of rice imported, the Minister had given instructions for the revision of the 02 Letters of Credit due for expiry on 20 February 2015, to import Ponni Samba Rice for the balance value of the Letters of Credit, to amend the Letters of Credit accordingly and inform the General Treasury accordingly. Nevertheless, attention had not been paid for the matters such as the receipt of the paddy crop of the Maha Season to the market by that time / the stocks of rice with the Lanka Sathosa stores and the stocks of rice with the private sector. (Annexe 35)

- (l) Even though Minister had instructed that the General Treasury should be informed of this matter, contrary to that and without approval, on the subsequent day itself, that is, the Bank of Ceylon had been informed by the unnumbered letter dated 13 February 2015, under the hand of a Director of the Lanka Sathosa and the Deputy General Manager (Finance) to extend the period of the Letters of Credit up to 20 April 2015. One of the then Additional Secretary of the Ministry had signed the letter as the Director and the Authority of this officer extend the Letters of Credit was not clear. (Annexe 36)
- (m) Even though the Deputy Secretary to the Treasury had, by his letter No. DFD/RICE/LS-2014 dated 25 February 2015, informed the Secretary to the Ministry communicating that **“the Secretary to the Treasury has instructed to desist from any further extension of the expired Letters of Credit as the paddy crop from the Maha Season of 2014/15 is being received by the market”**, by then the Bank of Ceylon already had extended the periods of 02 Letters of Credit totalling Rs.5,361,911,463 up to 17 April 2015. (Annexes 37, 38 and 39)
- (n) Even though the Deputy General Manager of the Bank of Ceylon had, by the unnumbered letter dated 04 March 2015, made request to the Deputy Secretary to the Treasury to extend the guarantees of the two Letters of Credit up to 31 July 2015, the Deputy Secretary to the Treasury had, by his letter No. DFD/RICE/LS-2014 dated 17 March 2015, informed the Bank that the **“Treasury can guarantee only the quantity of rice imported during the guarantee period of the original Letters of Credit due to the receipt of the crop of the Maha Season, the availability of stocks of rice in the market and as the Secretary to the Treasury has given instructions to desist from extending the guarantees of Letters of Credit”**. Despite so informing, 15 days after that, that is, by his letter No. DFD/RICE/LS-2014 dated 01 April 2015, the

Deputy Secretary to the Treasury had informed to validate the guarantee as that is valid up to 30 April 2015 stating that **“the Minister of Finance has given instructions”** and that the letter sent on 17 March 2015 will be withdrawn. (Annexes 40, 41 and 42)

- (o) The clause 46A(8) of the Original Letters of Credit dated 05 November 2014 which specified that payments should be made only after the receipt of a **Quality Certificate issued by Representative of the Applicant certifying that quality, quantity and packing conform to the specifications stated under field 45A of Letter of Credit. The name of the Representative and his passport number will be notified to the advising Bank in due course.** But that clause had been amended subsequently, that is on 18 November 2014 and inserted as **Should be amended to read as Quality Certificate up to 5,000 MT of Ponni Samba (GRII) with 5 pct broken issued by SGS India (Pvt) Ltd, India certifying that quality, quantity and packing conform to specifications stated under field 45A of Letter of Credit.**

Even that clause had been eliminated by the unnumbered letter dated 13 February 2015 sent under the hand of a Director of the Board of Directors of the Lanka Sathosa and the Deputy General Manager (Finance) for the extending the period of the Letters of Credit and inserted **Should be deleted and pls include Quality Certificate has been issued by the reputed independent survey at beneficiary cost and conforms to the specifications stated under field 45A of the Letter of Credit.** (Annexes 27, 28, 43 and 44)

- (p) An audit test check of 60 files out of the total of 169 files relating to the clearance of the rice imported under the above two Letters of Credit revealed that the Quality Certificates related to 09 of those files had not been produced while the Quality Certificates included in 02 files were Quality Certificates which did not relate to that rice imported (Annexe 45)
- (q) Even though the letter No. ACP/201314/OCT/EXPORTS/002 dated 01 September 2014 referred by the Indian Company named ACP Industries Ltd. to the Minister of Economic Development stated that **“the rice produced in the cultivated lands of the Company will be supplied”**. According to 60 files selected for the sample, other companies had taken action under all those files to supply rice on behalf of that company. (Annexes 29 and 46).
- (r) Instead of the notice issued to the Bank of Ceylon by the Deputy Secretary to the Treasury by his letter No. TO/REV/LC/443 dated 31 October 2014 to **“open an Irrevocable letter of Credit”** according to the Pro-forma Invoice No. ACP/201314/OCT/EXPORT/009 dated 24 October 2014 the Lanka Sathosa had opened the Letters of Credit as **Irrevocable Transferable**, thus allowing the occasion for the ACP Industries Ltd. to act as an intermediary and supply rice through other Companies. (Annexes 47 and 48)
- (s) Despite the order for 50,000 metric tons of white rice made by the Lanka Sathosa under the approval No. 14/0940/540/005 dated 31 July 2014 Cabinet of Ministers for import of 50,000 metric tons of rice and the receipt of 36,399 metric tons out of that by 29 October 2014, the letter No. CIT/5/6/RICE IMPORTS dated 23 October 2014 referred by the Secretary to the Ministry of Co-operatives and Internal Trade to the Secretary to the Ministry of Finance and Planning by referring again to the same approval of the Cabinet of Ministers and requesting for facilities for the grant of a loan of US\$ 45 million for the import of 100,000 metric tons of rice through the Lanka Sathosa is a questionable issue. (Annexes 15, 21, and 49)

(t) Long Periods taken for the release of Containers of Rice from the Port

- (i) Even though the Director General of the Department of Development Finance had, in the initial instance of opening of the Letters of Credit, by his letter No. DFD/RICE/LS/dated 13 November 2014, made a request to the Director General of Customs to release the “Stock of imported rice through the Green Channel” for the expeditious removal of the stocks of rice out of the total quantity of 90,901 metric tons of rice imported under the Letters of Credit No. BTD-M63519 and No. BTD-M63537 a stock of 42,992 metric tons or 47.3 per cent approximately had taken 04 months to 10 months for release from the Port. Specifically, the release of 398 and 245 containers had taken 09 months and 10 months respectively. (Annexes 50 and 51)

- (ii) Even though a concessionary period of 60 days had been allowed without payment of demurrage by the Sri Lanka Ports Authority on the requests made by the General Treasury, and the officers of the Lanka Sathosa as well as the Line Minister, the Lanka Sathosa had not taken action for getting the containers released expeditiously. According to the letter No. MPS/06/15/02-04 dated 10 July 2015 referred to the Secretary to the Cabinet of Ministers by the Minister of Ports and Shipping, he has informed that the Lanka Sathosa had to pay a sum of Rs.506,703,785 including the demurrage amounting to Rs.362,058,214 by 24 June 2015, that is, after the expiry of the concessionary period. (Annexe 52)

- (iii) No attention whatsoever had been paid to the quantities of rice already ordered under the other letters of credit and the Documents Against Payment System as well as the storage space available in the existing stores when the extension was sought for the Letters of Credit No. BTD-M 63519 and No. BTD-M 63537. As such, that had resulted in the deterioration of a large quantity of rice as well as subjecting the Lanka Sathosa to an unnecessary financial commitment.
- (iv) Similarly, the rice imported for human consumption had been kept in the Port premises in the containers in which rice was imported without appropriate environmental conditions under a proper methodology, leading to the deterioration of those stocks of rice.
- (u) Re-storage of 809 Containers of Rice released from the Port premises in 02 Private Containers Yards and Payment of Rs.15,638,362 in that connection

Even after the release of the containers of Rice imported under the Letters of Credit No. BTD-M 63519 and No. BTD-M 63537 after retaining those in the Port premises for 10 months the Lanka Sathosa had taken action to retain them in the ACE Container Yard and the Asian Container Yard instead of storing them in proper stores. The following matters were observed in that connection.

- (i) These Private Container Yards are maintained for the temporary retention of containers and the Lanka Sathosa had to pay ground rent at the rate of Rs.150 per container per day for the period of retaining the containers.

- (ii) These containers released after retaining them in the Port premises over a period of 10 months, had been further retained in the Private Container Yards since January 2016.
- (iii) According to the information obtained from the Lanka Sathosa and the Container Yards, 809 containers containing 21,034 metric tons of rice had been retained in those Container Yards and the Lanka Sathosa had taken over 727 containers after the elapse of 02 months to 10 months. (Annexe 53)
- (iv) The physical audit examination carried out on 14 October 2016 revealed that 82 containers containing 2,152 metric tons of rice continued to be retained in the ACE Container Yard and those containers had been brought to that Container Yard in January 2016. As such, action had been taken to retain those containers in that Yard over a period exceeding 09 months. (Annexe 54)
- (v) Out of those 82 containers in that Yard 02 containers selected at random were opened and examined and it was observed that the rice had perished due to water seeping in to the container and infested with worms and insects and emanating putrid smell. Photographs appear below.



- (vi) Environmental conditions suitable for the storage of containers with consumer commodities such as rice were not available at these Yards and it was observed that these stocks of rice exposed to rain and heat over long periods could not be fit for human consumption under any circumstances. These containers had been improperly stored over periods exceeding 19 months, that is, 10 months approximately in the Port premises and a further period in 9 months in the Private Container Yard.
- (vii) According to the information furnished to the Audit by the Senior Accountant on 03 November 2016, ground rent amounting to Rs.15,638,362 had been paid to the respective Container Yards in respect of the period up to 20 September 2016. Further payment of ground rent was due as 54 containers had been retained in that Yard even up to 16 November 2016. (Annexe 55 and 56)

5.6 Import of 61,354 Metric Tons of Rice by opening Letters of Credit No. 42002140033274 and No. 42002140033283

According to the request made to the Secretary to the Treasury by the then Minister of Co-operatives and Internal Trade by his unnumbered letter dated 28 November 2014 for the distribution of rice at concessionary price through the Lanka Sathosa as decided by the Government as a strategy for discouraging the trend in the increase of rice during the Election period (Presidential Election 2015) 30,000 metric tons of White Rice from the Indian Company named Trident Chempher Ltd. and 31,354 metric tons of Ponni Samba Rice from the Indian Company named United Foods (Pvt) Ltd. both costing Rs.3,781,156,555 under the Letters of Credit No. 42002140033274 and No. 42002140036283 respectively issued by the People's Bank 03 December 2014. (Annexes 57, 58 ,59 ,60 and 61)

The observations in this connection are given below.

- (a) In response to the request made to the Secretary to the Treasury by the then Minister of Co-operatives and Internal Trade by his unnumbered letter dated 28 November 2014 for making available financial facilities for the import of Ponni Samba Rice and Nadu Rice at the rate of 50,000 metric tons each, the Director General of Department of Development Finance had made note that **“the Secretary to the General Treasury revised as the rate of 30,000 metric tons”** had expressed the concurrence of the Treasury by his letter No. DFD/RICE/LS-2014 dated 01 December, for the import of 30,000 metric tons of Ponni Samba Rice and 30,000 metric tons of White Rice. The approval for this had not been obtained from the Cabinet of Ministers (Annexes 57 and 62)
- (b) The Deputy Secretary to the Treasury had, by his letter No. TO/REV/LC/449 dated 04 December 2014, issued instructions to the People’s Bank to supply financial facilities to the Lanka Sathosa for the import of rice in the absence of such approval. (Annexe 63)
- (c) The provisions in the Government Procurement Guidelines, as referred to in paragraph 5.1 (b), had not been followed in the selection of the Indian Suppliers, namely, the Trident Chempher Ltd. and the United Foods Ltd. (Annexe 10)
- (d) As referred to in paragraph 5.1(c) above, the Lanka Sathosa had not entered into contracts with the 02 suppliers in the purchase of the above rice valued at Rs.3,781,156,555. (Annexe 11)
- (e) The above suppliers had been nominated and sent by the Ministry of Co-operatives as referred to in paragraph 5.3(f) above. (Annexe 19)

- (f) Even though the Lanka Sathosa had ordered for 193,460 metric tons of rice by 03 December 2014, by using its own funds, on the approval of the Cabinet of Ministers and on the concurrence of the Treasury, the Letters of Credit had been opened for the import of 60,000 metric tons of rice. Out of the rice so ordered, 78,794 metric tons had been received even by 03 December 2014. (Anexes 20 and 21)
- (g) Despite the receipt of the stock of 50,000 metric tons of White Rice ordered under the Letter of Credit opened on 01 September 2014 by 09 November 2014, due to ordering for 30,000 metric tons of White Rice on 03 December 2014 without considering the situation, the total quantity of White Rice ordered during the year 2014 amounted to 80,000 metric tons.

5.7 Import of 25,000 Metric Tons of Nadu Rice from the Government of Bangladesh on the Government to Government Basis

The Ministry of Finance and Planning had submitted a Cabinet Memorandum No. DFD/CM/2014-03 dated 12 November 2014 on the subject – obtaining 50,000 metric tons of Rice from the Government of Bangladesh for Creating Food Security. According to an agreement entered into with the Government of Bangladesh on 03 December 2014, a stock of 25,000 metric tons of Nadu Rice valued at Rs.1,504,335,376 had been purchased. (Annexes 64 and 65)

The Cabinet of Ministers had given the approval dated 12 November 2014 for the following proposals made in the Cabinet Memorandum referred to above.

(Annexe 66)

- (i) To grant authority to the Lanka Sathosa Ltd. to enter into an agreement with the Ministry of Food of Bangladesh for obtaining 50,000 metric tons of rice at US\$ 450 per metric ton from Bangladesh Government.
- (ii) The Bank of Ceylon to give the financial facilities required for the import of this quantity of 50,000 metric tons of rice to the Lanka Sathosa Ltd.
- (iii) To authorize the General Treasury to give the letters for the supply of the necessary facilities for the financial facilities supplied by the Bank of Ceylon and the People's Bank to the Lanka Sathosa Ltd. for the import of rice.

The observations in this connection are given below.

- (a) Even though the approval of the Cabinet of Ministers had been received for the import of 50,000 metric tons of rice from the Government of Bangladesh, contrary to that, an agreement for the import of 25,000 metric tons only had been signed on 03 December 2014. As such, the reasons for the import of a quantity of rice lesser than the quantity approved were not revealed. (Annexes 65 and 66)
- (b) In terms of the Guideline 8.9.3 of the Government Procurement Guidelines and 8.9.3 of the Procurement Manual, the contract agreements relating to supply of goods and services more than equal to Rs.500 million should be signed by the Secretary to the Line Ministry. Nevertheless, contrary to that, the agreement for the import of 25,000 metric tons of rice valued at Rs.1,504,335,376 from the Government of Bangladesh had been signed by the Chairman of the Lanka Sathosa. (Annexe 11)

- (c) The Lanka Sathosa had been taking action by 10 December 2014 for the import of 253,460 metric tons of rice by using its own funds, on the approval of the Cabinet of Ministers and the concurrence of the Treasury and out of that stocks of rice, 80,154 metric tons had been received by that date. The balance stocks were in the process of receiving. Nevertheless, the parties concerned had not presented matters or paid attention in this connection at the time of submitting the Cabinet Memorandum. (Annexes 20 and 21)

- (d) According to the letter No. bhc-col/14/230.06 dated 24 September 2014 of the High Commissioner for Bangladesh an invitation had been made for a team with expert knowledge from Sri Lanka to visit Dacca, the Capital of Bangladesh to discuss the standard, price and the procurement procedure relating to the stock of rice and 03 officers of the Treasury and the Chairman of the Lanka Sathosa had participated during 30 September to 02 October 2014. (Annexes 67 and 68)

- (e) Even though a request was made to send a team with expert knowledge to Bangladesh, whether an officer with the expert knowledge of the standard of rice had participated was not clear.

6. Balance Stock of Imported Rice

According to the quantity of rice imported and the quantity of rice sold by the Lanka Sathosa, a stock of 23,751 metric tons of rice out of the stock of 257,559 metric tons of rice imported as shown below should be further available in the stores and containers as at 30 November 2016. (Annexes 69 and 70)

	Metric Tons
Quantity of Rice imported	257,559
Quantity Sold for Human Consumption	(176,208)

	81,351
Quantity released for Animal Feed	(57,600)

Balance Stock of Rice as at 25 November 2016	23,751
	=====

The following observations are made in this connection.

- (a) After the adjustment of the information on the rice imported and sold furnished by the Senior Accountant on 30 November 2016, the balance stock that should be available as at 25 November 2016 had been 23,751 metric tons whereas according to the information furnished by the Manager (Operation) on 30 November 2016, the balance stock as at that date amounted to 15,804 metric tons. As such a difference of 7,947 metric tons existed in the balance stock of rice. (Annexes 69, 70 and 71)
- (b) The balance stocks of rice in the stores and containers are at present subject to deterioration largely.

- (c) It was not possible to establish in audit the quantity and the value of the balance due to the failure to maintain accurate stock records and the failure to network all Sales Outlets.
- (d) The balance stock of rice included 1,404 metric tons of rice in 54 containers retained at the ACE Container Yard. Even though 19 months had elapsed after the import of that stock of rice, those further remained in the containers in which the rice was imported. (Annexe 56)
- (e) Information of the different varieties of rice (Ponni Samba, Nadu and White Rice) included in the stock of 23,751 metric tons that remained as at 25 November 2016 was not available.
- (f) Even though a period exceeding 19 months had elapsed after the importation of the balance stock of 23,751 metric tons of rice costing Rs.1,543,815,000 (23,751,000 x 65) as at 25 November 2016, there was no evidence of the future action that will be taken on those stocks of rice subject to deterioration.

7. Total Cost Incurred on Imported Rice

According to the information made available by the Minister of Ports and Shipping, the Senior Accountant of the Lanka Sathosa, the Director General of Sri Lanka Customs, the Senior Manager of the Bank of Ceylon and the Chief Executive Officer of the People's Bank on 10 July 2016, 03, 29 and 30 November 2016, 01 December 2016, 10 December 2016 and 29 November 2016 respectively sums totalling Rs.27,011,980,142 had been paid / remains payable for the purchase of 257,559 metric tons of imported rice. (Annexes 52, 55, 72, 73, 74 and 75)

Category of Expenditure	Value (Rs.)
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CIF Value of 257,559 Metric Tons of Imported Rice	15,996,534,772
Customs Duty Payable	5,835,656,743
Loan Interest Paid and Payable (Bank of Ceylon and People's Bank)	1,931,434,240
Clearance, Transport and Demurrage Charges on Imported Rice	1,712,645,855
Demurrage and Other Expenses paid / Payable to the Port	694,325,310
Port Charges	404,307,958
Rent of Private Stores	213,038,701
Customs Duty Paid	132,770,828
Stores Labour Charges	52,100,114
Expenditure of Fumigation	15,318,179
Penalty Interest Payable on Outstanding Loans of the People's Bank	7,994,752
Insurance Charges for Stores	6,455,731
Deposits for Government Stores	5,287,830
Expenditure on Electricity for Stores	1,932,160
Rent of Government Stores	1,849,969
Legal Expenses	327,000

Grand Total	27,011,980,142
	=====

The observations in this connection are given below.

- (a) As a sum of Rs.27,011,980,142 had been paid / remain payable as at 10 December 2016 for the import of 257,559 metric tons of imported rice, the cost per 01 kilogramme of imported rice amounted to Rs.105.
- (b) Out of the sum of Rs.1,712,645,855 spent in the year 2014, 2015 and 2016 on the clearance, transport and demurrage of the imported rice, a sum of Rs.1,502,852,590 had been granted as advances to Liverpool Navigation (Clearing Agency) and out of the sum of money so given, a sum of Rs.302,963,336 had not been settled even by 18 October 2016. (Annexe 76)
- (c) Penalty interest as at 21 November 2016 amounting to Rs.7,994,752 remained payable due to the failure to pay the loan installments of the People's Bank as specified. (Annexe 75)
- (d) Even though the Ministry of Industry and Commerce (the then Ministry of Food Security) should have taken action to settle the following duties and taxes totalling Rs.5,835,656,743 that remained payable to the Sri Lanka Customs on the 148,750 metric tons of rice imported by the Lanka Sathosa after 15 January 2015 from the savings of the budgetary provisions of the year 2015, action had not been taken even by 30 November 2016 for the settlement of those outstanding duties and taxes. Those duties and taxes amounting to Rs.5,835,656,743 are to be borne by the Government as the Ministry should pay this outstanding amount in the future through budgetary provision. (Annexe 73)

The information on the Customs Duty and other taxes payable is given below.

	Ministry of Food Security	Ministry of Industry and Commerce
	Rs.	Rs.
Customs Import Duty (CID)	476,560,000	1,020,495,000
Ports and Airports Levy (PAL)	45,014,388	97,030,524
Nation Building Tax (NBT)	30,237,832	65,343,957
Value Added Tax (VAT)	166,307,996	351,741,266
Special Commodities Levy (SCL)	3,582,925,780	-
	4,301,045,996	1,534,610,747

- (e) The Bank loan interest paid and payable amounting to Rs.1,931,434,240 had been computed by the People's Bank and the Bank of Ceylon only up to 21 November 2016 and 09 December 2016 respectively. As such the sum of Rs.7,786,400,532 remaining further payable and the interest for the periods after those dates remain payable. (Annexes 74 and 75)
- (f) As stocks of 23,751 metric tons of rice still remain in the stores and private Yards, rent of stores, demurrage on rice containers, transport charges and labour charges for the period after 30 September 2016 remain further payable.

8. Total Income from the Sale of Imported Rice

According to the information made available to audit by the Senior Accountant of the Lanka Sathosa on 30 November 2016, the Lanka Sathosa had obtained a sales income totalling Rs.11,854,949,124 as shown below, from the sale of imported rice at subsidized prices and from the sale for animal feed. (Annexes 69 and 70)

Year	Variety of Rice	Quantity Sold	Sale Price (Per Kilogramme)	Income from Sale
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		(kg)	Rs.	Rs.
2014	White Rice	19,233,670	50	961,683,495
	Nadu Rice	27,982,128	55	1,539,017,034
	Ponni Samba	55,608,410	60	3,336,504,573
2015	White Rice	53,789,534	50	2,689,476,705
	Nadu Rice	7,234,819	55	397,915,050
	Ponni Samba	12,359,204	60	741,552,267
2016	Animal Feed	57,600,000	38	2,188,800,000
		-----		-----
Total		233,807,765		11,854,949,124
		=====		=====

The observations in this connection are given below.

- (a) Even though the letter No. CIT/6-13/Import dated 27 November 2014 of the Secretary to the Ministry of Co-operatives and Internal Trade addressed to the Chairman of the Lanka Sathosa stated that **“The Minister had received instructions from the President to sell rice at subsidized price”** the evidence in support of the basis of which the prices were determined had not been furnished. (Annexe 77)

- (b) According to the letter No. DFD/CIT/2015 dated 02 January 2015 of the Director General of the Department of Development Finance addressed to the Secretary to the Ministry of Co-operatives and Internal Trade stated **“that it was decided at a meeting between the representatives of the Co-operative Societies and the Secretary to the Ministry of Finance and Planning held on 01 January 2015, to sell rice at subsidized price”**. But the evidence in support of the basis on which the prices were determined had not been furnished. (Annexe 78)
- (c) According to the letter No. 101/Sec/Ins/01 dated 15 July 2015 of the Secretary to the Ministry of Industry and Commerce addressed to the Chairman of the Lanka Sathosa stated **“that the Department of Development Finance informed that the Minister of Finance had given instructions for reducing the price of Ponni Samba Rice from Rs.75 to Rs.69 with effect from 15 July 2015”**. But the evidence in support of the basis on which the prices were determined had not been furnished. (Annexe 79)
- (d) Out of the Stock of 257,559 metric tons of rice imported by the Lanka Sathosa, the sale of 3,048 metric tons and 85,000 metric tons of rice as animal feed had been decided by the Cabinet Sub-committee on Cost of Living at the meeting held on 17 November 2015 and according to the Cabinet decision No. 16/0454/723/14 dated 16 March 2016 respectively. Accordingly, 57,600 metric tons of the stock of 257,559 metric tons of rice imported or 22.36 per cent had been sold by 16 October 2016 for Rs.2,188,800,000 at Rs.38 per kilogramme. (Annexes 69,80 and 81)

9. Loss of Rs.15,157,031,018 incurred by the Lanka Sathosa / Government on the Importation of Rice

Even though the Lanka Sathosa had incurred a cost of Rs.27,011,980,142 on the imported of rice during the year 2014 and 2015 as shown as in paragraph 07, a sum of Rs.11,854,949,124 as shown in paragraph 08 only had been received from the sale of rice. As such, the Lanka Sathosa had incurred a loss of Rs.15,157,031,018 from the importation of rice.

10. Supply of Funds for the Importation of Rice

The opening of the Letters of Credit for the importation of rice had been made through the Bank of Ceylon and the People's Bank. Even though loans totalling Rs.14,086,576,123 had been obtained from those Banks for the Letters of Credit, a further sum of Rs.8,939,763,519 consisting of loans and interest remained further payable as at 21 November 2016 and 09 December 2016. Details appear below. (Annexe 74 and 75)

Bank	Loans Obtained	As at 21 November / 09 December 2016		Loans Repayable	Installment Payable and Penalty Interest
		Loans Repaid	Interest Paid		
	Rs.	Rs.	Rs.	Rs.	Rs.
Bank of Ceylon	7,449,088,123	901,489,803	224,267,074	6,547,598,320	1,114,170,335
People's Bank	6,637,488,000	5,398,685,788	561,798,931	1,238,802,212	39,192,652
	14,086,576,123	6,300,175,591	786,066,005	7,786,400,532	1,153,362,987

The following observations are made in this connection.

- (a) Even though the approval of the Cabinet of Ministers No. 16/0454/723/014 dated 24 March 2016 for the payment of the loans and interest from the Treasury to the above Banks amounting to Rs.8,336,067,913 and Rs.418,335,864 respectively totaling Rs.8,754,403,777 had been received, the loans and the interest had not been paid by the Treasury up to date. (Annexe 81)

- (b) At the time of maturity of the two Letters of Credit No. BTD-M 63519 and No. BTD-M 63537, totalling Rs.6,000,000,000 (US\$ 45,000,000), that is 20 February 2015 only 9,813 metric tons of rice valued at Rs.591,833,640 had been imported. If action had been taken by paying attention to the market requirements of rice and the existing stocks and desisted from extending the period of the Letters of Credit, it would have been possible to refrain from obtaining a loan of Rs.5,361,911,463 from the Bank. If the period of the Letters of Credit had not been extended, the loans and interest payable to the Banks as at 09 December 2016 would have been only Rs.1,388,332,244 instead of Rs.7,661,768,655. (Annexes 33, 74 and 75)

11. Need for Procurement of Additional Storage Facilities for Imported Rice

As the stocks of rice imported by the Lanka Sathosa without paying attention to the rice requirements of the market and the available storage space, had been received during a short period, the stores of the Public and Private Sectors had to be procured in addition to the stores used until then, on the monthly rental basis. The following observations are made in this connection.

- (a) Ten stores belonging to the Department of Food Commissioner and 10 stores of the Private Institutions / Individuals had been procured and a total sum of Rs.220,176,500 comprising Rs.7,137,799 and Rs.213,038,701 respectively had been paid for the period from the year 2014 to 30 September 2016. (Annexes 72 and 82)
- (b) The provisions in the Government Procurement Guidelines, as referred to in 5.1 (b) above, had not been followed in the selection of stores. As a consequence, stores had been procured without carrying out a formal examination of the capacity, prices and conditions of the stores. (Annexe 10)
- (c) The monthly rent payments had been made on the measurements produced by the owners due to the failure to follow the procurement procedure. The physical measurements made subsequently by the Engineering Division of the Lanka Sathosa revealed that the measurements produced by the owners in connection with 07 stores had been erroneous. Accordingly, a sum of Rs.9,246,260 overpaid as rent of stores had been recovered by the Lanka Sathosa on 04 November 2016. (Annexe 83)

- (d) Unsuitability of Stores for storage of Rice
- (i) Three stores belonging to a private individual situated at Ekala had been procured and the Storekeeper and the Public Health Inspectors had made statements that those stores were buildings of an abandoned factory. The physical audit examination of the nature of the stores revealed that the floors were defectively cemented, roofs had holes and that there were gaps between the doors through which rats, dogs and birds could creep through.
- (ii) The additional report No. B/398/16 in connection with the existing weaknesses of the Veyangoda Stores submitted on 11 March 2016 by the Veyangoda Public Health Inspector to the Attanagalla Magistrate's Court, as well revealed the weaknesses of the stores. (Annexe 84)
- (iii) The Magistrate's Court, Attanagalla had issued an order to the Director of the Department of Animal Production and Health at Gannoruwa on 21 March 2016, to examine and furnish a report on the rice stored at Veyangoda. According to the Report submitted to the Court on 11 May 2016 in response to that order, the following matters relating to the weaknesses in the stores had been submitted. (Annexe 85)
- ❖ Stores Nos. 01, 08 and 13 are in unsatisfactory sanitary condition.
 - ❖ Walls and roofs are damaged
 - ❖ Water had seeped through the roofs and walls
 - ❖ Existence of a considerable quantity of damaged bags of rice and perished rice

(e) Failure to follow correct Methodology for Storage of Rice

- (i) As Storekeepers had not been attached at the time of commencing the storage of rice in the stores at Veyangoda and Ekala, action had been taken to appoint two officers who had functioned as “**Multi Duty Assistants**” in the Lanka Sathosa. But those appointments had not been made in writing. Action had not been taken for the appointment of officers with an adequate knowledge or experience in stores administration as well as for providing training on stores maintenance, rice storage methodology, recording and issue to the officers appointed.
- (ii) No information / register whatsoever relating to quantity of rice in the containers (number of bags), variety of rice, information on the weight, etc. had been given to the officers in charge of the stores when the containers with rice were brought to the Stores. Action had not been taken for installing weighing machines in the stores.
- (iii) In view of the receipt of a large numbr of containers and the lack of knowledge in storing, it had not been possible to store the rice under the First In First Out (FIFO) method. As such rice had to be retained in the stores over long periods. (Annexe 80)
- (iv) Rice had not been stored in a manner for easy physical count or for following other safety methodologies such as fumigation, and stored on the floor instead of on pallets. (Annexe 80)
- (v) Even the stocks of rice damaged due to retention over long periods in the Port premises and the Private Container Yards, had been stored in the same stores with good quality rice. This had resulted in the exposure of good quality rice for early decay. (Annexe 80)

(vi) The Report of the Five Member of Committee with the Chairmanship of the Food Commissioner appointed by the Secretary to the Ministry of Industry and Commerce on 16 October 2016 to examine the imported rice also revealed the information on weaknesses prevailing in the stores methodologies. (Annexe 80)

(f) Failure to carry out a Physical Stock Count

Rice had been received by the stores at Veyangoda and Ekala with effect from 08 October 2014 and 25 November 2014 respectively and the Lanka Sathosa had not taken action in any instance whatsoever for the computation of the accuracy of the quantity of rice received, examine the method of storage and the examination of the accuracy of the registers. As such the accuracy of the information on the quantities of the available stocks of rice furnished by the Store keepers could not be established.

12. General Observations

- (a) Even though 97.5 per cent of the issued capital of the Lanka Sathosa is held by the Secretary to the General Treasury, taking into consideration the observations in the above report, there was no evidence that the Secretary to the Treasury had shown any interest or given any instructions. (Annexe 04)
- (b) According to the information in the letter No. SEPC/STAT/AUDIT/(DOA) dated 07 November 2016 sent by the Director of the Socio-economic Planning Centre of the Department of Agriculture, except in the case of the year 2014, the local production of rice had exceeded the actual consumption during the years 2012, 2013 and 2015. But rice had been imported in the years 2012, 2013 and 2015. (Annexe 86)
- (c) According to the report furnished to the Secretary to the Ministry of Food Security on 06 February 2015, despite the unavailability of adequate stocks of rice for local consumption in the year 2014, the Co-operative Wholesale Establishment (CWE) had exported 4,015 metric tons of rice in the year 2013 and 2014 to the Prateek General Trading in Dubai. (Annexe 87)
- (d) Even though the officers of the Ministry of Industry and Commerce and the Officers / Chairmen of the Institutions under its purview and the officers of the Ministry of Finance participate in the Sub-committee on the Cost of Living which decides on the Cost of Living and the Consumer Commodities of the country, it was not revealed that the Sub-committee had taken decisions based on accurate information.
- (e) Attention to the local production of rice in the country, the stocks of paddy with the Paddy Marketing Board, the stocks of rice imported by the Department of Co-operative Development in the year 2014 and the stocks of rice with the Private Sector, had not been paid in making decisions for the import of rice.

- (f) The existence of problems relating to the accuracy of the information and data furnished to the Audit by the Lanka Sathosa.

- (g) The officers in charge of the store had not been able to record the accurate information on the quantity and the variety of rice in the containers due to reasons such as the lack of documented information on the rice contained in the containers, lack of equipment for weighting and the arrival of a large number (90 Container on certain days) of containers on certain days. Differences between the registers of the Storekeepers and the Import Documents (Bills of Lading) were observed due to such reasons. A test check carried out by the Audit revealed that 3,562 metric tons of Nadu Rice imported in 134 containers under 05 Bills of Lading had been recorded as receipt of 3,379.6 metric tons in the registers of the Storekeepers, thus indicating a difference of 182.4 metric tons. The Lanka Sathosa had not conducted any investigations of such differences whatsoever.
(Annexe 88)

- (h) An Analysis of the stock position of the Lanka Sathosa at the times of placing orders for the importation of this rice could not be carried out as the accurate information on the monthly sales and the existing stocks of the Lanka Sathosa had not been furnished.

13. Systems and Controls

The following weaknesses in the Systems and Controls were observed.

- (a) All sales outlets and the stores had not been linked to the Information System of the institution.
- (b) A formal Stock Control System was not in operation in all stores.
- (c) The formal classification of income and expenditure in the accounting activities and the maintenance of files thereon had been at a weak level thus resulting long delays in the preparation of financial statements.
- (d) The responsibility for the functions of the institution had been at a weak level as recruitment to most of the posts in the higher management had been made on contract basis.
- (e) Inadequacy in providing replies to the Internal Audit Queries and taking action thereon.
- (f) Major decisions of the institution had not been taken at the discretion of the Board of Directors, and in different occasions the Chairman, the General Treasury and the Line Ministry had intensely intervened in that connection.
- (g) Handing over / taking over of official files in writing when officers are recruited by the institution or leaving the service had been at a weak level.
- (h) Action on procurements had been taken outside the Government Procurement Guidelines.
- (i) Duties had not been assigned in writing to the officers of the institution.
(Annexe 88)

14. Recommendations

The following recommendations are made.

- (a) The need for the officers of the Ministries and those of the Institutions under their purview participating in the Sub-Committee on Cost of Living to take action to furnish accurate information to the Cabinet of Ministers.
- (b) The need for paying due attention to the data and information of the Central Bank of Sri Lanka and the Department of Census and Statistics relevant to the overall position of the country in reaching decisions relating to productivity, demand and importation of rice.
- (c) As the Lanka Sathosa is a State Company, the need for carrying out a proper supervision of its activities by the Department of Public Enterprises, the Department of Management Audit, the Department of Treasury Operations and the Department of Management Services of the General Treasury.
- (d) The need for obtaining accurate data on the local requirement of rice, the paddy production and the overall stock levels of the country before taking decisions for the importation of rice.
- (e) The need for the officers responsible for supplying all requirements of information in the Cabinet Memorandums presented to the Cabinet of Ministers in order to enable the Cabinet of Ministers to take correct decisions.
- (f) As the Lanka Sathosa is a State Company, the need to follow the provisions in the Government Procurement Guidelines in the N.P.A. Circular No. 08 dated 25 January 2006 in all procurements as a formal Procurement Procedure has not been approved by the Institution.

- (g) The need for annual registration of eligible suppliers and purchases in emergency situation to be made by inviting quotations from those suppliers.
- (h) The need for carrying out the Procurement Process safeguarding the economy, efficiency and effectiveness aspects in order to safeguard the Value for Money Concept.
- (i) The need for carrying out a further review of the staff required for the institution and the recruitment of qualified and experienced persons for the vacancies created in the approved staff so prepared and retention of such officers in the institution.
- (j) The need for the takeover and handover of the official files of all officers according to a formal methodology.
- (k) The need for the establishment of a computer information system in the institution and link all sales outlets and stores of the Lanka Sathosa to that system.
- (l) The need for introducing a proper stock control methodology for every sales outlets and store.
- (m) The need for all important decisions of the Institution to be placed before the Board of Directors for its decision.
- (n) The need for the officers of the Treasury represented in the Board of Directors to provide better instructions.
- (o) The need for strengthening the Internal Audit and make it function in an orderly manner.
- (p) The need for entering into agreements signed by the appropriate authorities in terms of the Guidelines 8.9.1 (b) of the Government Procurement Guidelines and Guideline 8.9.3 of the Procurement Manual in the supply of all goods and services valued over Rs.500,000.

15. Conclusions

- (a) It is concluded that the Procurement Process of import of 250,693 metric tons of rice valued at (CIF) Rs.15,691,695,005 in the years 2014 and 2015 had not been directed in accordance with the primary objectives of the Procurement Process, namely,
- Maximising economy, timeliness and quality in Procurement resulting in least cost together with the high quality,
Adhering to prescribed standards, specifications, rules, and regulations.
Providing for, equal and maximum opportunity for eligible interested parties to participate in the Procurement.
Expeditious delivery of goods and services and
Ensuring transparency and consistency in the evaluation and selection procedure.
- (b) It is concluded that the officers responsible for the loss of Rs.15,157,031,018 revealed in this Report should be identified and that the Procurement Process should be made formal in order to prevent the recurrence of such losses in the future.
- (c) It is concluded that, action had been taken for the import of rice, without due consideration of its impact on the agro economy of the country.
- (d) It is concluded that there were instances in which the important information relevant for making procurement decisions had not been made available through Cabinet Memorandums to the Cabinet of Ministers.
- (e) It is further concluded that with regard to the action not taken to obtain the approval of the Cabinet of Ministers for the import of 182,548 metric tons of rice costing Rs.11,648,592,399 and with regard to the supply of Government funds without appropriate approval, the officers concerned are liable for the responsibility.

- (f) This report was prepared within the limitations of the mandate, resources and time available to the Auditor General and the examination did not go beyond the scope and examine whether there were illegal or criminal activities on which the Auditor General cannot make any conclusions and if it is perceived that such inquiry should be carried out, I conclude that it is appropriate to seek the assistance of the institutions specialized in such fields.