

**REPORT OF THE AUDITORS
TO THE MEMBERS OF
CEYLON FERTILIZER COMPANY LIMITED**

We have audited the Balance Sheet of Ceylon Fertilizer Company Limited, as at 31 December 2002 and the related statement of income for the year ended, together with the accounting policies and notes.

Respective Responsibilities Of Directors And Auditors

The directors are responsible for preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standards. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis Of Opinion

We conducted our audit in accordance with the Sri Lanka Auditing Standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the directors, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standards. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion so far as appears from our examination, and to the best of our information and according to the explanations given to us, the Financial Statements do not give a true and fair view of the financial position of the Company as at 31st December 2002, and of the results of its operations for the year then ended in accordance with Sri Lanka Accounting Standards, for the reasons that follow.

1. Accounting Policies (SLAS 3.20)

Management should select and apply an enterprise accounting policies, so that the financial statements comply with all the requirements of each applicable Sri Lanka Accounting Standard. Management should ensure that financial statements provide information that is reasonable in that they reflect the economic substance of events and transactions and not merely their legal form.

The Company's accounting policies, Notes 1.1, 2, 3 and 4.1 are not in accordance with Sri Lanka Accounting Standards.

2. Revaluation Of Property, Plant And Equipment (SLAS 18.34)

Most of the fixed assets of the Company are fully depreciated. Some of these are listed below at written down values.

| | Rs. |
|------------------|------------|
| Office Furniture | 36,650 |
| Workshop Tools | 32,264 |
| Other Equipment | 19,883 |
| Bicycle | 7,397 |
| Mixing Plants | 10 |
| | ----- |
| | 96,204 |
| | ===== |

Revaluation under SLAS 18 should take place once in 3 – 5 years. **However the last revaluation was done in 1992 (10 years ago).**

3. Depreciation Of Property, Plant And Equipment (SLAS 1.43)

The depreciable amount of an item of property, plant and equipment, should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the assets economic benefits are consumed by the enterprise. **The mixing plants were not depreciated**, although their mixing capacity was 63,458 MT and was in use during the year.

4. Revenue (SLAS 29.6)

Turnover (Revenue) is the gross economic benefits during the period arising in the course of ordinary activities of an enterprise, when those inflows result in increases in equity.

Consignment sales of Rs 162,949,967 to Thamankaduwa Agro Fertilizer Company Ltd should have been included with the Head Office, Hunupitiya and D.F.S. total turnover Rs 1,614,418,027. (Accounting Policy Note 4.1). This omission has also resulted in the net loss on consignment Rs 62,624,553 being charged to other operating income. This in turn resulted in the net operating income being shown at a deficit of Rs 21,762,338.

5. Cash Flow Statement (SLAS 9.12)

The amount of cash flow arising from operating activities, is a key indicator of the extent to which the operations of an enterprise have generated sufficient cash flows to repay loans, maintain the operating capability of the enterprise, pay dividends and make new investments, without recourse to external sources of financing

The fertilizer subsidy receivable from the Government Rs 745,193,356 has been shown as a deduction from cost of sales when arriving at the operating income. It should have been shown as an income from financing activity, especially as the Company is heavily dependent on the treasury. We have not received a cash in transit certificate Rs 3,593,744.25

6. Non Current Assets

Current assets are stated in the Balance Sheet as Rs 1,897,878,359. (Accounting Policy Note 2) included in the above are the undermentioned non current assets.

| | Rs.'000 |
|----------------------------|----------------|
| 1. Insurance Investment | 59,904 |
| 2. Gratuity Investment | 19,838 |
| 3. Housing Loan Investment | 921 |
| 4. Treasury Subsidy | 130,328 |
| 5. Import Debtors | 16,996 |
| 6. Other Trade Debtors | 43,871 |
| | ----- |
| Total | 271,858 |
| | ==== |

The general treasury subsidy Rs 130,328,770 is due from 1988. A Cabinet decision has been passed in parliament to pay this amount, although it remains unpaid to date.

7. Non Current Liabilities

Current liabilities are stated in the Balance Sheet as Rs 1,351,577,499 (Accounting Policy Note 3). Included in the above are the undermentioned non current liabilities.

| | Rs.'000 |
|-----------------------------|----------------|
| 1. Insurance Fund | 59,904 |
| 2. Gratuity Fund | 19,946 |
| 3. Housing Fund | 921 |
| 4. Treasury Special Account | 1,680 |
| | ----- |
| | 82,451 |
| | ==== |

The treasury special account Rs 1,680,000 has been outstanding since 1990. No interest has been paid to date.

8. Contingent Assets (SLAS 36.10)

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non occurrence of one or more uncertain future events, not wholly within the control of the Enterprise.

The proposed Colombo Katunayake Express Highway will run through the Hunupitiya Complex premises. A part of the stores building will have to be demolished, and a new building erected with the mixing plant being re located. The total cost is estimated at Rs 72,901,794. The Road Development Authority has agreed to reimburse this amount (Source Budget 2002)

9. Contingent Liability (SLAS 36.86)

Unless the possibility of any outflow in settlement is remote, an Enterprise should disclose for each class of contingent liability at the Balance Sheet date, a brief description of the nature of the contingent liability. 3536 MT (Net) of Fertilizer on loan as at 31.12.2002 has not been reflected even as a contingent liability.

10. The undermentioned accounts have been outstanding for more than 5 years and the settlement of these are in doubt.

| | Head Office Rs. | Hunupitiya Rs. | DFS Rs. | Tamankaduwa Rs. |
|--------------------------------|--------------------|-------------------|------------|--------------------|
| Debit Balances | | | | |
| Wayamba – Returned cheque | 140,612 | | | |
| Ruhunu - Returned cheque | 306,274 | | | |
| Rajarata - Returned cheque | 316,463 | | | |
| Head Office – Returned cheque | 808,714 | | | |
| Import Debtors | 16,996,783 | | | |
| Sundry Debtors | | | | 55,899 |
| Shortages On Sales | 932 | | 284,025 | |
| Stock Shortages | | | 3,522,119 | |
| Cash Shortages | | 59,767 | 493,784 | |
| Prepayments | | 10,000 | | |
| Staff Loan – Rajarata | 241,229 | | | |
| Festival Advance – R/ Weligama | 13,650 | | | |
| Credit Balances | | | | |
| Excess On Sales | 644,494 | 18,026 | 1,554,919 | |
| Sundry Creditors | 357,219 | 1,340,096 | | 205,805 |
| Retention Money | | 449,851 | | |
| Refundable Deposit | 9,500 | | | 16,000 |
| Receipts In Advance | 342,801 | 47,000 | | 15,236 |

11. Freehold Land Rs 60,240,000

The title deeds to the undermentioned properties were not made available to us.

| | Rs.'000 |
|------------|----------------|
| Hunupitiya | 60,000 |
| Akuressa | 100 |
| Dodangoda | 140 |
| | ----- |
| Total | 60,240 |
| | ===== |

12. Fertilizer Stock Rs. 427,912,025

The Company does not maintain separate Fertilizer Stock Ledger Control Accounts for Hunupitiya and District Fertilizer stores (in value). This weakness in the system is open to abuse. We did not observe the counting of the physical inventories as at 31st December 2002, since that date was prior to the time, we were initially engaged as auditors of the Company.

It was also observed from the Company's own quantity reconciliation that a quantity of 11,120 M.T. of fertilizer had been received on loan by Ceylon Fertilizer Company Ltd. This matter needs further clarification, as the liability to third parties has not been disclosed.

CHARTERED ACCOUNTANTS
Colombo : 14 July 2003

CEYLON FERTILIZER COMPANY LIMITED
PRINCIPAL ACCOUNTING POLICIES

1 General

1.1 Accounting Convention

Financial Statements are prepared in accordance with Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka. No adjustments have been made for inflationary factors affecting the Financial Statements. Where appropriate the policies are explained in the succeeding notes.

1.2 Foreign Currencies

Foreign exchange payments during the period have been accounted for, on the basis of actual payment. Assets and Liabilities are translated at the exchange rates ruling at the Balance Sheet date.

1.3 Taxation

The Trading Profit and Income of the Company is liable to income tax at the rate of 30% under the provisions of the Inland Revenue Act. No. 28 of 1979

1.4 Events Occurring After The Balance Sheet Date

All material post Balance Sheet events have been considered and where appropriate adjustments to or disclosures have been made in the financial statements.

2. Assets And Bases Of Their Valuation

Assets classified as current assets on the Balance Sheet, Cash and Bank balances and those which are expected to be realized in cash during the normal operating cycle or within one year from the Balance Sheet date, whichever is shorter.

CEYLON FERTILIZER COMPANY LIMITED
PRINCIPAL ACCOUNTING POLICIES

2.1 Property Plant And Equipment

Property, Plant and Equipment are stated at cost or revaluation less accumulated depreciation.

2.2 Depreciation

Depreciation is not provided for Land. All other Property, Plant and Equipment are depreciated on the straight line basis. Estimated useful lives are as follows.

| | |
|---------------------|---------------|
| Building | Over 40 Years |
| Plant And Equipment | Over 10 Years |
| Mixing Plant | Over 05 Years |
| Office Furniture | Over 10Years |
| Office Equipment | Over 03 Years |
| Work Shop Tools | Over 05 Years |
| Lab Equipment | Over 03 Years |
| Other Equipment | Over 03 Years |
| Motor Vehicle | Over 05 Years |
| Bicycles | Over 03 Years |
| Canteen Equipment | Over 05 Years |

Depreciation is not provided on additions but full year of depreciation is provided on disposal.

2.3 Inventories

Inventories are stated at cost, the cost is determined on first in first out basis and includes all expenses incidental to purchasing. In the case of finished products cost includes all direct expenditure and production overheads based on a normal level of activity.

CEYLON FERTILIZER COMPANY LIMITED
PRINCIPAL ACCOUNTING POLICIES

2.4 Debtors

Debtors are stated at their estimated realizable value. The provision for bad debts on trade debtors has been made at the following rates on principle outstanding.

| | | |
|----|-----------------------------|------|
| 1. | Over three months to 1 year | 5% |
| 2. | One Year to two Years | 10% |
| 3. | Two Years to Three Years | 10% |
| 4. | Excess of Three Years | 100% |

3. Liabilities And Provisions

Liabilities classified as current liabilities on the balance sheet are those which fall due for payment on demand or within one year from the balance sheet date. Non current liabilities are those balances that fall due for payment after one year from the balance sheet date. All known liabilities have been accounted for in preparing the financial statements.

3.1 Gratuity

Provision has been made for the payment of retirement benefits and gratuity in terms of the Gratuity Act. No. 12 of 1983.

3.2 Insurance Fund

A provision has been made for an Insurance Fund with an investment to meet liabilities in excess of insurance claims.

CEYLON FERTILIZER COMPANY LIMITED
PRINCIPAL ACCOUNTING POLICIES

4. Income Statement

4.1 Turnover

Turnover represents the invoiced value of fertilizer rates, less turnover tax and trade discounts at the Head Office Hunupitiya Central Ware Housing Complex and the District Fertilizer Stores.

4.2 Fertilizer Subsidy

A subsidy is receivable for the import of Urea Fertilizer. This has been incorporated in cost of sales.