Land Reclamation and Development Company Limited and is subsidiary Company - 2017

The audit of the financial statements of the Land Reclamation and Development Company Limited and its subsidiary Company for the year ended 31 December 2017 and the comprising the consolidated statement of financial position as at 31 December 2017 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, 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. My comments and observations relating to the activities of the Company which I consider should be reported to Parliament in terms of Article 154(6) of the construction of the Democratic Socialist Republic of Sri Lanka appear in this report.

1.2 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standard for small and medium- sized entities (SLFRS for SMEs) and for such internal control as the Board determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor`s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Qualified Opinion

(a) Sri Lanka Accounting Standard for Small and Medium – size Entities

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Following non – compliances were observed.

(i) Paragraph 17 – Property Plant and Equipment

The building valued at Rs.4,216,275 occupied by the Company during the year under review had been shown as working progress in the financial statements instead of being shown as buildings and depreciation thereon had not been provided and the depreciation thereon had not been provided.

(ii) Paragraph 27 – Impairment of Assets

A cement block machine, block preparation plates which had been purchased on 15 July 2015 on finance lease for Rs.4,508,000 and Rs.2,695,000 respectively had not been utilized up to end of the year under review. However, no impairment losses thereon had been identified.

(iii) Paragraph – 33 – Disclosure of related party Transactions

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- The transactions between the related parties and the reporting entity, disregarding exchange of cash, exchange of resources services and obligations, had not been disclosed in the financial statements.

- The short term service benefits, post service benefits, other long term benefits, termination benefits of the service had not been disclosed in the financial statements.

(b) Accounting Policies

The following observations are made.

(i) According to Accounting Policies No.2.2.2, it had been stated that the provision for doubtful debts had been made only on for the specified debtors. However, without being specifically identified the debtors for the provisions, a sum of Rs.2,887,524 had been provided as doubtful debts.

(ii) Even though it had been disclosed that identification of revenue had been made on the Engineer's certificate the revenue had been identified on cash basis.

(c) Accounting Deficiencies

The following observations are made.

(i) Four advance balances totalling Rs.140,000 payable to the sub – contractors since the year 2012 had been accounted for as income from sale of remains of those contractors and shown as a sales income in the financial statements. As a result, sales income had been over stated by that amount.

(ii) According to the calculations made by audit, deferred tax liability as at end of the year under review amounted to Rs.2,791,982. However, that value had been shown as Rs.1,283,852 by the Company. Hence, the differed tax liability had been understated by Rs.1,508,140.

(iii) The computations made by audit based on the financial statements presented, the non-controlling interest of the miner shareholders amounting to Rs.4,050,700. However, that amount had been shown as Rs.3,590,971 in the financial statements and as a result that value had been under stated by Rs.459,729.

(d) Lack of Evidence for Audit

The evidence shown against the following items shown in the financial statements had not been furnished to audit.

	Item	Value (Rs.)	Evidence not made available
(a)	Petty Cash given to the sites	335,224	Balance Confirmations
(b)	VAT receivables	7,871	Balance Confirmations
(c)	Long term loans	1,200,000	Detailed scheduled and loan agreements
(d)	Trade and Contract debtors	11,290,178	Balance Confirmations
(e)	Trade and other Payable	5,269,178	Balance Confirmations

(e) Unexplained Difference

(i) A difference of Rs.32.71 million was observed in 07 balances shown in the financial statements amounting to Rs.114.18 million, due to non-reconciliation of them with the correspondent schedules.

(ii) A difference of Rs.1,136,940 was observed when compared to the service fee payable to the subsidiary Company, for the security services obtained from the LRDC Services Private Company during the year under review. Not adjusting the effect of inter company transactions in the consolidated financial statements, was the main reason for that difference.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.4 of this report the financial statements give a true and fair view of the financial position of the Land Reclamation and Development Company Limited and subsidiary as at 31 December 2017, and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards for Small Medium-sized Entities.

2.1.1 Report on other Legal and Regulatory Requirement

As required by Section 163(2) of the Companies Act, No.07 of 2007, I state the followings:

(a) The basis of opinion and scope and limitations of the audit are as stated above.

(b) - I have obtained all the information and explanations that required for the audit except for the effects of the matters described in basis for qualified opinion and as far as appears from my examinations, proper accounting records have been kept by the Company.

- In my opinion, The financial statements of the Company comply with the requirement of Section 151 and 153 of the Companies Act, No. 07 of 2007.

2.2 Accounts Receivable and Payable

The following observations are made.

(a) The mobilization advance receivable balance as at end of the year under review amounted Rs.37 million. Of that balance, a sum of Rs.14.93 million was existed as the receivable for a period ranging from 2 to 5 years and a sum of Rs.19.11 million was outstanding for over 5 years. The Company had not taken actions to recover those advance balances.

(b) Action had not been taken to recover a sum of Rs.1.92 million from the Land Reclamation and Development Corporation for the supply of labour during the year under review.

(c) Out of the trade and contract debtors as at end of the year under review amounting to Rs.18.613 million, the reminders had been sent to recover the loans only for 1 per cent of debtors valued at Rs.192,822. The debt recovering progress was at lower level.

(d) Out of the retention money receivable relating to the construction contracts as at end of the year under review amounted to Rs.87.55 million, a sum of Rs.64.21 million was receivable for a period from 2 to 5 years and a balance of Rs.7.84 million was older than over 5 years.

(e) The retention money payable to the sub-contractors, relating to the construction contract, as at end of the year under review amounted Rs.53.01. Out of that balance, sums of Rs.39.89 million and Rs.5.81 million were older than for a period ranging from 1 to 5 years and over 5 years respectively.

(f) The Mobilization advances payable relating to the construction contracts as at end of the year under review amounting to Rs.69.37 million. Out of that amount, sums of Rs.30.17 million and Rs.22.84 million were older than for a period from 1 to 5 years and over 5 years respectively.

(g) The debtor balances and credit balances of the company as at end of the year under review amounted to Rs.18.76 million and Rs.22.01 million respectively. Out of those balances, debtor balance for over 1 year amounted to Rs.11.4 million and creditor balance for over 1 year amounted to Rs.12.58 million.

(h) Even though a sum of Rs.174,450 had been shown in the financial statements as at end of the year under review as an unsettled fuel deposits, as per the fuel supplier, that amount had been settled.

2.3 Non – Compliance with Laws, Rules, Regulations and Management Decisions

The following non – compliances were observed.

Reference to Laws, Rules and Regulations etc.	Non – Compliance
(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka :	
- Financial Regulation 371 and the Public Finance Circular No.03/2015 dated 14 July 20	Even though the advances should be settled immediately after completing of the intended work, unsettled advance balance even after lapse of one month amounted to Rs.258,559.
(b) Financial Administration Code of the Company	
(i) Section 3.1.1	Even though the maximum payable advance amounting to Rs.50,000, action had been taken to give the advances totaling Rs.325,000 in 3 instances contrary to that.
(ii) Section 3.2.1 (d) 3	The supply Division of the Company should responsible for the on Account Payments and within 30 days, on Account payment should be settled and if there is receivable balance, action should be taken to recover that balance in cash or by a cheque. However, unsettled on Account payment as at end of the year under review, lapse of 30 days amounted to Rs.1,095,541 and adequate actions had not been taken by the management to recover the payments.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial results of the Group and the Company had surplus of Rs.21.78 million and Rs.10.21 million respectively. As compared with the corresponding surplus of Rs.27 million and Rs.3.6 million respectively for the preceding year. Thus, indicating deterioration in the financial result of the Group and the Company of Rs.5.22 million and Rs.6.61 million respectively.

3.2 Analytical Review

Significant rations of the Company relating to the year under review and the preceding year are shown below.

	2017	**2016**
Equity ratio	2.35	0.23
Gross Profit ratio	14.53	9.49
Net Profit ratio	4.02	0.87
Current ration	1.64	1.37
Quick ratio	1.23	1.04
Debtors run over ratio	13.55	16.2
Debts collection period	26	23

Compared to the preceding year, even though the contract income and other operational income of the Company had decreased by Rs.167.6 million, the gross profit ratio had been increased to 18.8 per cent during the year under review from 9.49 per cent of the year 2016 due to decrease of cost of sale by Rs.164.5 million. However, the sales and distribution expenditure and financial expenditure had been increased by 183 per cent and 63 per cent respectively.

04. Operational Review

4.1 Performance

4.1.1 Planning

In terms of Section 5.1 of the Public Enterprises Circular No.PED/12 dated 02 June 2003, the company had not prepared a Corporate Plan and an Action Plan for the year under review. As a result, the performance of the Company could not be evaluated in audit.

4.1.2 Activities and Revenue

The following observations are made relating to operational activities of 7 Factories and the Workshop of the Company.

(a) Except the Nawala precast factory and the Hgurakgoda factory, the operational loss of other 5 factories and the workshop as at 31 December 2017 totalling Rs.17.62 million.

(b) Even though the capacity of the Nawala Cement block factory was 1,200 blocks, the Company and the Labour unions had agreed manufacturing of only 800 blocks per day. Hence, the Labour cost had been increased due to under utilization of the capacity and extending of dates required for manufacturing. This situation had been directly attributed to this loss making situation. A sum of Rs.8.50 million had been incurred for direct labour of manufacturing of cement blocks and it represented 49 per cent of annual income of from the cent block manufacturing.

(c) Due to non – performing of the Hambantota factory during the year under review, a loss of Rs.352,262 had to be increased.

(d) Even though there was a high capacity in the Kotagala factory, for manufacturing of cement blocks, in the due to the lack of adequate demand the manufacturing cost and over heads had been represented high value. However, actions had not been taken to increase the demand by the Company.

(e) Compared to the preceding year, the profit of the Trincomalee factory had been deteriorated by 584 per cent and decrease of sale income by 39 per cent had been attributed for that situation.

4.2 Management Activities

The following observations are made.

(a) A sum of Rs.2.6 million had been paid to acquire the land belonging to the Kotagala factory, extent of 1 acres and 31 purchs, on the estimate made in the year 2002 for Rs.10 million. However, that land had not been acquired up to end of the year under review.

(b) A stock valued at Rs.32,161 belonging to 4 categories and manufactured in the years 2013 and 2014 had not been used up to end of the year under review and or adequate attention had not been drawn to dispose them. Further, the Gabian nets, purchased in the year 2013 for Rs.623,150 had not been utilized.

(c) Without having any written document, 150 hume pipes valued at Rs.4,200,000 had been stored at the Nawala Factory premises since the year 2014 and the reasons to stored so at the premises and owners of the items had not been explained to audit.

(d) After being recruited of 111 officers on behalf of staff of the Parent Corporation had been placed in the Parent Corporation on the basis of 5 per cent service income during the year under review. Nevertheless, the Board approval had not been obtained to engage in labour supply activities. Further, that was not complied with the objectives stipulated in the Article of Association of the Company and a written agreement had not been signed between two parties.

(e) Action had not been taken to pay the dividends amounting to Rs.4,555,193 to the share holders of the company as at end of the year under review, based on the Board paper No.2014/89/554 dated 10 October 2014.

(f) Action had not been taken to acquire a lorry, owned by the Housing Development Authority, which has been used by the Company since the year 2012, for the estimated value of Rs.1,250,000, up to end of the year under review.

(g) Elven Board meetings had been held by the company during the year under review and except two Directors, the Chairman and other Directors had participated a lower as 3 to 9 meetings.

4.3 The Resources Released to other Public Institutions

Three employers had been released to the Sri Lanka Land Reclamation and Development Company during the year under review and a sum of Rs.2,028,828 had been paid as salaries and allowances for them. However, action had not been taken to recover that amount from the Corporation.

4.4 Staff Administration

The following observations are made.

(a) The approved cadre of the Company as at 31 December 2017 was 107 and actual cadre as at that date was 79. Thus, 28 vacancies were existed. Out of those 28 vacancies, 04 Middle Management posts had been vacant for over 4 years and 11 Management Assistants and 13 permanent labours had been vacant. This situation had been affected to smooth operations of the Company.

(b) Even though a requirement procedure had been prepared by the Company, the procedure for requirement of General Manager of the Company had not been included to the procedure.

5. Accountability and Good Governance

5.1 Internal Audit

An internal Auditor had not been appointed and an internal audit had not been carried out during the year under review.

5.2 Budgetary Control

In terms of the Public Enterprises Circular No.PED/12 dated 02 June 2003, an Annual Budget had not been prepared.

5.3 Procurements and Contract process

5.3.1 Procurements

The following observations are made.

(a) Eighteen mobilization advance balances amounting to Rs.6,773,808 were as at end of the year under review and action had not been taken to obtain advance security bound for 11 advances out of the above advances.

(b) Even though the capital expenditure amounting to Rs.9,031,854 had been incurred by the Company during the year under review, a procurement plan had not been prepared by the Company in terms of Section 4.2 of the Government Procurement Guideline.

5.3.2 Deficiencies in Contract Administration

The following observations are made.

(a) None of the works had been performed during the year under review relating to 19 contract that had been shown as work-in-progress valued at Rs.36,490,267 as at beginning of the year under review. Defaulting of the contract activities by the sub – contractors had been the main reason in this connection.

(b) Even though a sum of Rs.50,291,865 had been incurred by the Company, for the direct construction contracts for the year under review, the Company had failed to recover any income from the clients. The deficiencies in the work done was the main reason for that situation. Further, although a sum of Rs.12,040,034 had been paid by the Company for the sub-contractors during the year under review, recoveries had not been made from the clients. This situation had been badly affected for the liquidity position of the Company.

(c) Without being examined the bills submitted by the sub-contractors with the work done, a sum of Rs.19,888,000 had been paid in 14 instances for those bills as “on account payments”.

(d) Sixteen contracts had been taken over by the Company during the year under review from various state institutions and those contracts had been given to sub-contractors. The contracts had been assigned to lowest bidders after being called quotations from competitive bidders. However, it was observed that evaluated bid prices, of 4 contracts had been further deduced from 5 per cent to 10 per cent after being discussed. Reducing of bid prices subsequent to the bid evaluation and application of various percentages for price amendments were a problematic issue in audit and it was observed in audit that such situation would have been a reason for termination of contracts by the sub-contractors.

(e) Actions had not been taken to extend the validity period of 16 performance bounds amounting to Rs.32,354,491 submitted by the sub-contractors to the Company during the year under review.

(f) As a practice, he contracts received to the Company during the year under review had been given to sub-contractors, without being performed them directly. Due to that practice, the Company had earn only 3 to 5 per cent profit margin from the contracts.

6. Systems and Controls

The deficiencies observed during the course of audit was informed to the Chairman of the Company in time to time. Special attention is needed for the following areas of control.

	Areas of Control	Observations
(a)	Control of credit sales	Determination of credit sales only on the approval of the General Manager of the Company, conducting the and examining and approving procedure for sales – invoices.
(b)	On Account payments	(i) On Account payments had been made, without being settled the previous on account payment balances, and not recovering of on account payments during the stipulated period, according to the circular instructions.
		(ii) The Company had not made the on account payment formally and an internal control system had not been implemented thereon.
(c)	Maintaining of Documents	(i) Not updating of factory work sheets and Registers.
		(ii) Even though the main function of the Company is construction contracts, a formal contract register had not been

		maintained.
(d)	Financial Control	The petty cash balances had not been settled for long period of time and action had not been taken for identifying them.
(e)	Accounting	(i) The accounting format of the accounting software of the Company had not been matched with the management accounting format that required furnish with the monthly accounting reports.
		(ii) Even though the Finance Division of the Company had prepared a financial manual, that manual had not been covered all financial functions of the Company.