

State Development and Construction Corporation - 2022

1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the State Development and Construction Corporation (“Corporation”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018 and Finance Act No. 38 of 1971. My comments and observations which I consider should be report to parliament appear in this report.

I do not express an opinion on the accompanying financial statements of the Corporation. Because of the significance of the matters discussed in the basis for disclaimer of opinion section of this report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.2 Basis for Disclaimer Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I was unable to obtain appropriate and sufficient audit evidence to express audit opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Corporation’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Corporation’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Corporation is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Corporation.

1.4 Audit Scope

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Corporation , and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Corporation has complied with applicable written law, or other general or special directions issued by the governing body of the Corporation;
- Whether the Corporation has performed according to its powers, functions and duties; and
- Whether the resources of the Corporation had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Audit Observation on preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
<p>(a) Sri Lanka Accounting Standard No.01 - Presentation of Financial Statement</p> <p>(i) As per the paragraph No.25 of the standard and as per the paragraph 4.1 of the Conceptual framework for Financial Reporting, management shall make an assessment of entity's ability to continue as going concern and uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. However, management had not disclosed regarding going concern in the summary of significant accounting policies in the Financial Statement. However, total asset of the corporation as at 31 December 2022 was Rs.7,592.7</p>	<p>Directors of the Corporation have made an assessment on the corporation's ability to continue as a going concern in the foreseeable future and they have not foreseen a need for liquidation or cessation of business, while preparing the annual accounts for year 2022.</p> <p>Also we need to highlight that in year 2023, corporation has moved towards difference business perspectives such as vehicle maintenance and repairs, sleeper manufacturing and maintenance</p>	<p>Management should make a reasonable assessment of entity's ability to continue as going concern and disclosed regarding the material uncertainties.</p>

million and external liabilities were Rs.6,754.25 million or 88 percent from the total assets. Further the recoverability of due from customers which was already identified as income by the finance division but not invoiced was amounting to Rs.1,898.86 million was uncertain but not sufficient provision was made.

work, emergency construction work and skilled training for foreign and local employment etc. Also bond facility has been negotiated with the Bank of Ceylon (BOC) in October 2023, supporting its operational requirements.

Hence the board reiterates that it foresees Corporation having going concern within its operations.

(ii) As per paragraph No.32 of the standard, the assets and liabilities, income and expenditure should not be offset against each other unless required or permitted by the Sri Lanka Financial Reporting Standards. However, credit balances of purchase advances and sundry advances amounting to Rs.4.27 million had been offset against the debit balances of such accounts. As such current assets had been understated by the same amount.

We will rectify the credit balances in the next year.

Being offsetting of assets versus liabilities and income versus expenditure causes to misrepresent of financial standards.

(iii) As per the paragraph no.29 of the standard an entity shall present separately items of a dissimilar nature as functions unless they are immaterial. However it was observed that capital work-in-progress amounting to Rs. 6.08 million had been included under Property Plant and Equipment without shown separately in the statement of Financial Position.

Building work in progress will be transferred to building after completion. This will be shown separately in year 2023.

Fair presentations should be ensured as per the standard.

1.5.2 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
(a) According to the financial statements, a balance of Rs.3,519.81 million remained as Due from Customers which was identified as income from construction contracts by the finance division but not invoiced to customers. However, as per	Committee has been appointed in clearing the uncertain due from customer balance also, provision has already been made in the annual accounts for the uncertain due from customer balance.	Reasons for difference should be determined and adequate provision should be made for uncertainty accordingly.

the documents submitted by the construction division, only a sum of Rs.1,620.95 million has been confirmed as Due from customers. As such, a difference of Rs.1,898.86 million was observed and reasons for the difference were not determined. Therefore, it was observed that recoverability of this different amount is highly uncertain. Further, as per the age analysis, out of the total Due from customers Rs.2,560.22 million was over 03 years and Rs.1820.56 million was over 06 years. However, the Corporation had not recognized these uncertainty and adequate provision had not been made.

(b) Interest expense for term loans for the year under review has been decreased by Rs.102.82 million from Rs.199 million in previous year, due to approval of two deferments for repayment of loan installments and interests there on from March 2022 to January 2024 (21 months) by the Bank of Ceylon. However, Corporation had not disclosed this matter in the financial statements in the year under review.

(c) During the year under review an adjustment has been made through a journal entry, to the opening and closing stock of finished good of cost of sales to the value of Rs.53.8 million. Accordingly closing stock under cost of sales has been duplicated and as a result profit for the year has been overstated by that amount.

(d) Surcharge imposed by Inland Revenue Department for nonpayment of Value Added Tax, National Building Tax and Economic Service Charges aggregating to Rs.961.81 million had not been recognized or disclosed in the financial statement for the year under review.

-

Management should disclose every material information that effect to the decision of the stakeholders.

Noted

Necessary measures to be initiated to ensure the accuracy and reliability of accounting treatments made in the financial statements.

It had not been recognized in the financial statements of the year 2022 and it has been taken into accounts in the year 2023.

Necessary measures to be initiated to ensure the accuracy and reliability of the financial statements.

- | | | |
|---|---|---|
| (e) As per information furnished to the audit, VAT payable as at 31 December 2022 was amounted to Rs.1,474.19 million including the VAT for the year under review amounted to Rs.124.43 million. However, the same had been shown as Rs.1,236.19 million in the Financial Statement. Thus, the VAT payable had been understated by Rs.238 million in the Financial Statement. | This difference amount will be rectified in the year 2023. | Necessary measures to be initiated to ensure accurate information are recorded in the financial statements. |
| (f) The corporation had recognized Rs.3.81 million as audit fee for the year under review. However, as per the details submitted all of these audit fees were not relevant to the year under review but relevant to previous years. Therefore profit for the year had been understated by same amounts. | Noted. Since Rs.3.81 million was considered as a comparatively smaller figure, attempt were not made adjust prior year. | Only the relevant income and expenses should be considered when assessing the profit for the year. |
| (g) Bond charges amounting to Rs.1.54 million had been included erroneously in welfare and Recreation expenses. | Noted. However erroneous entry has no impact on the final profit. | Expenses should be properly categorized for the fair presentation of the financial statements. |

1.5.3 Documentary Evidences not made available for Audit

	Item		Management Comment	Recommendation
Item of Account	Value Rs. Million	Evidence not made available		
(a) Sundry Advances and Purchase Advances – Construction	19.47	Age Analysis	Committee will be appointed to clearing this amount. Age analysis will be provided in year 2023.	All documentary evidence should be submitted for audit to satisfactorily examine and assure the existence accuracy and completeness of the balances.
(b) Letter of Credit Margin Account	151.08	Detail Schedule and Details of Goods Received	Committee has been appointed to clearing this amount.	
(c) Sundry Debtor	29.91	Detail Schedules	Schedule will be provided in the year 2023.	

(d)	Ready mix debtors	34.80	Detail Schedules
(e)	Construction Debtors	399.37	Debtor Confirmations
(f)	Retention Construction	– 573.10	Debtor Confirmations
(g)	Traffic Light System Debtors	28.47	Debtor Confirmations
(h)	Concrete Yard Debtors	52.64	Debtor Confirmations
(i)	Asphalt Debtors	1.62	Debtor Confirmations

Balance confirmations will be provided in the year 2023.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue

Debtors of concrete yard, construction, traffic light system and liquidated damages receivable, retention receivable and purchase advances totaling to Rs.691.23 million had remained over 03 years without being recovered.

Management Comment

Corporation is following up of recovering these debtors.

Recommendation

Action should be taken effectively to recover the outstanding balances by the responsible officers.

1.6.2 Payables

Audit Issue

Mobilization advances received was amounting to Rs.32.34 million as at 31 December 2022 remained over 05 years without being settled.

Management Comment

Noted

Recommendation

Steps need to be taken to settle these balances.

1.7 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka F R 756	Board of Survey Report had not been furnished to the Auditor General for the year under review up to 31 October 2023.	It will be submitted in year 2023.	Board of survey should be done by the Corporation annually to ensure the existence of the non-current assets and the such report should be submitted to audit.
(b) Employee Provident Fund Act No.15 of 1958	EPF contributions and Surcharges thereon amounting to Rs.143.26 million had not been paid to the Employee Provident Fund since 2020.	Due to the covid 19 pandemic, which effected since the first quarter of year 2020, the cash flow position of the corporation was at a very poor level. Furthermore, the economic crisis had adversely affected to the construction industry and thereby, have caused difficulty in settling the large sum of unsettled EPF contribution. Action is being taken to settle the same, through the restructuring Corporation.	Step need to be taken to settle these statutory payments.
(c) Procurement Guideline/ NPA Circular No.08, dated 25 January 2006, Section 5.4.4 (iii)	The mobilization advances received shall be fully settled before the project works reached to 90 per cent of complete level. Nevertheless, such advances received amounting to Rs.10.28 million with regard to 12 fully completed projects had remained in the	Noted	Due attention should be paid to comply with the Circular.

accounts as at 31
December 2022 without
being settled.

1.8 Cash Management

Audit Issue	Management Comment	Recommendation
(a) The Corporation had obtained loan for a period of 03 months amounting to Rs.596.12 million from the State bank by discounting bills worth Rs.792.83 million received from the Road Development Authority with regard to construction contract done by the Corporation. The Corporation has paid interest amounting Rs.17.52 million due to non-settlement of these bills from Road Development Authority to the bank within prescribe period of 03 months.	Agreed.	Actions should be taken to minimize interest expenses by using suitable strategies.
(b) Term loan balances which were taken from two state banks, as at 31 December 2022 was Rs.1,848.24 million and the value of differed loan balances was Rs.1,727.18 million. In terms of these loans Rs.990.61 million had been granted under treasury guarantee and for Rs.518.60 million, corporation has pledged the lands of the corporation as guarantee.	Banks had granted a loan deferment till end of January 2024. General Treasury of Sri Lanka has already granted approval for the deferment of the Treasury guaranteed loan.	The management of the corporation should pay its attention of paying loans and interest as per new conditions of deferment.

1.9 Non Compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
(a) VAT and Surcharges thereon since 2006, were amounting to Rs.2,403 million had not been remitted to the Inland Revenue Department, in accordance with Value Added Tax Act No.14 in 2002.	Management comment had not been submitted.	Corporation should be comply with the provision of the Value Added Tax Act.

- | | | |
|---|--|---|
| (b) Nation Building Tax and Surcharges thereon were amounting Rs.7.15 million had not been paid since 2010, in accordance with Nation Building Tax Act No.09 in 2009. | NBT liability will be settled at the restructuring of corporation | Corporation should be comply with the provision of the Nation Building Tax Act. |
| (c) ESC payable amounting to Rs.101.23 million had not been paid to Inland Revenue Department, in accordance with Service Charges Amendment Act No.13 of 2015 | ESC liability will be settled in the restructuring process of corporation. | Corporation should be comply with the ESC Act. |

2. Financial Review

2.1 Financial Results

Operations of the Corporation during the year under review had resulted in a pre-tax net profit of Rs.26,921,045 as compared with the corresponding pre-tax net profit of Rs.96,124,611 for the preceding year, thus indicating a severe decrease of Rs.69,203,566 in the financial results for the year under review. Decreasing of revenue and increasing of administrative expenses were the main reason for attributed for this financial result.

3. Operational Review

3.1 Operating inefficiencies

Audit Issue	Management Comment	Recommendation
(a) The project for Dismantling of Muwagama Old Bridge at Rathnapura had been undertaken on verbally instructions by the Corporation in the year 2013, without entering into formal contract agreement between Road Development Authority and the Corporation. After completing the dismantling process in 2019, the Corporation had submitted the invoice worth of Rs.53.63 million to Road Development Authority to recover the cost of dismantling and transporting. This amount has not been recovered so far.	Corporation is following up in collecting this amount	Action should be taken to recover the outstanding balance from RDA.
(b) Even though, Corporation had incurred Rs.5.84 million for Gemstone mining project contrary to the objectives of the corporation in the year under review at Monaragala. Any revenue had not been earned up to the year ended 31	Agreed.	Corporation should be taken decision according to the objective of the Act.

December 2022.

(c) According to profit calculation schedule, the loss of totaling Rs.128.91 million had been identified from 17 construction projects out of 92 projects implemented as at 31 December 2022.	The construction was stopped due to a lack of funds. Idling claim will be made for overhead expenses to relevant period. In covid period, the work was stopped due to transport restriction and scarcity of material.	Necessary actions should be taken to minimize the loss from constructions.
(d) Due to Devcoshowa (Pvt) Ltd the fully own subsidiary of the Corporation had been inactive, the board had taken a decision in the year 2006 to wind up the Company. The winding up process was not completed even by 31 October 2023.	The Audit Management Committee (AMC) meeting of the Ministry of Transport and Highways held on 15.09.2023, Secretary to the Ministry has instructed Additional Secretary to the Ministry to obtain instructions from the Department of Attorney General regarding this matter.	The Corporation should take action to complete the winding up process

3.2 Underutilized Property, Plant and Equipment

Audit Issue	Management Comment	Recommendation
It was observed in the physical inspection at head office in Rathmalana that 39 motor vehicles, machinery and equipment at a cost of Rs.114.98 million remained to be repaired as at 31 December 2022. Although a sum of Rs.19.23 million had been estimated for the repair, it had not been done by the Corporation up to 31 October 2023.	Due to the prevailing financial hardship of the corporation, unable to repair the vehicles and Machinery equipments. Since most of the projects are on hold, there is no demand for the said vehicles and equipments. Will repair and use the above, when a requirement occurs in future.	Action should be taken to ensure that assets are properly utilized.

3.3 Human Resources Management

Audit Issue	Management Comment	Recommendation
(a) The approved cadre of the Corporation as at 31 December 2022 was 489 while the actual cadre was 565. Accordingly, this was shown an excess recruitment of 76 employees to the	The corporation had to recruit staff on contract basis based on the labour recruitment of the construction work carried out.	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic

Corporation for the various positions.		basis.
(b) One post of higher management in the corporation had remained vacant as at 31 December 2022. In addition to that, there were 03 vacancies of 02 Chief Engineers (concrete yard) and a Chief Engineer (Design).	A request has been made to the Management Service Department to get the approval to fill this vacancy	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic basis.
(c) The approved cadre for civil engineers was 19; however 51 Civil Engineers had been recruited as contract basis without approval.	The corporation had to recruit staff on contract basis based on the labour recruitment of the construction work carried out.	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic basis.
(d) The 20 Security Guards had been recruited exceeding the approved cadre.	The corporation had to recruit security staff to safeguard the assets in project sites in different regions in the country in the year 2022.	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic basis.

4. Accountability and Good Governance

4.1 Submission of Financial Statements

Audit Issue	Management Comment	Recommendation
According to Public Enterprises Circular, No. 01/2021 dated 16 November 2021, Section 6.6, draft annual report and accounts should be handed over to the Auditor General within 60 days after the close of the financial year. Nevertheless, financial statements pertaining to the year under review had been furnished to the Auditor General on 13 July 2023 delaying 134 days.	The Corporation Annual Accounts year 2022 were prepared and forwarded for approval to the Board of Directors (BOD) on 02 March 2023. Since the BOD were new and they requested time for review and the same was approved on 06 July 2023.	Due attention to be paid to comply with the Circular.