Maganeguma Consultancy and Project Management Services Company (Pvt) Limited - 2016

The audit of financial statements of the Maganeguma Consultancy and Project Management Services Company (Pvt) Limited ("the Company") for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 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.

This report is issued in terms of provisions in Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

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 Standards 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 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) A sum of Rs.1,000,000 had been transferred by the Road Development Authority (RDA) in the year 2004, to issue the Company shares to the RDA. However, without being issued the shares to the RDA, the above amount had been shown as long term liability in the financial statements. As a result, share capital of the Company had been understated by that amount.

b) No action had been taken to review useful lifetime of the fully depreciated assets purchased at a cost Rs. 16,477,085 which are still in used and a disclosure had not been made in the financial statements regarding the gross carrying amount of those assets.

c) According to the financial statements of the Company, the receivable amount from the RDA amounted to Rs.234,729,483. Nevertheless, according to the confirmation made by the RDA, the payable amount to the Company amounted to Rs.154,954,506. However, a reconciliation had not been made by the Company in order to identify the reasons for the difference of Rs.79,774,977.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Maganeguma Consultancy and Project Management Services Company (Pvt) Ltd as at 31 December 2016 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards for Small and Medium-sized Entities (SLFRS for SMEs).

2.1.1 Report on Other Legal and Regulatory Requirements

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

i. The basis of opinion and scope and limitations of the audit are as stated above.

ii. In my opinion, except for the effect of such adjustments, as might have been determined to be necessary had I been able to satisfy myself as to the matters disclosed in the basis of qualified opinion paragraph.

- I have obtained all the information and explanations that were required for the audit and as far as appears from my examination, proper accounting records have been kept by the Company.

- The financial statements of the Company comply with the requirements of Section 151 of the Companies Act, No. 07 of 2007.

2.2 Accounts Receivable and Payable

The following observations are made.

(a) The balance of debtors and other receivables from related parties as at 31 December 2016 was amounted to Rs.63,763,762 and out of that, a sum of Rs.10,587,421 had not been recovered for over 5 years.

(b) Accrued expenditure amounting to Rs.4,124,668 were remained in the accounts for the period ranging from 01 to 05 years without being taken actions to either settle those liabilities or treated as revenue, after assessing the obligation thereon.

(c) A sum of Rs.3,930,483 payable to a related company had not been settled for over a year.

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

The following Instances of non-compliance with Laws, Rules, Regulations and Management Decisions were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions	Non- compliance
(a) Inland Revenue (Amendments) Act, No. 10 of 2006	
(i) Section 61	As per the provisions in the Act, the dividend tax should be paid once the dividend paid to the shareholders. However, the dividend tax amounting to Rs. 577,373 had been paid based on the provision made for paying dividends even though the Company has not yet been proposed to pay dividends to its shareholders.
(ii) Section 127(a) and (b)	Pay As You Earn (PAYE) tax for the months of May and December 2016 amounting to Rs.253,528 had not been remitted to the Department of Inland Revenue within the stipulated date.
(b) Economic Service Charges (Amendments) Act, No 13 of 2006	Economic Service Charges for the year of assessments 2016/2017 amounting to Rs. 1,919,164 had not been remitted yet.

(c) Value Added Tax (Amendments) Act, No 14 of 2002	Total turnover declared in the Value Added Tax (VAT) returns was differing from the total turnover disclosed in the financial statements. Hence, the total turnover shown in the VAT returns had been overstated by Rs 47 million. In analyzing the turnover reconciliation, it was revealed that the turnover relating to year 2015 amounting to Rs. 49 million was erroneously included in the VAT returns prepared for the year under review. However, clear reasons for the difference had not been furnished to audit.
(d) Stamp Duty (Amendments) Act, No. 12 of 2006	Stamp duty had not been deducted from the salaries of each employee and remitted to the Department of Inland Revenue since commencement of the Company.
(e) Public Enterprises Circular No. PED/12 dated 02 June 2003 on Public Enterprises Guidelines for Good Governance	
(i) Paragraph 7.4.3	The Company had not prepared a Master Procurement Plan, Procurement Time Schedule and Procurement Budget for the year under review.
(ii) Paragraph 9.2 (d)	The approval for the Organization Chart and the Cadre of the Company had not been obtained from the Department of Public Enterprises of the General Treasury.
(iii) Paragraph 9.3.1 (i)	The Scheme of Recruitments and Promotions for the Company had not been prepared in order to obtain the approval from the Department of Management Services.
(f) Public Enterprises Circular No. PED 58 of 29 April 2011- Paragraph 2.5	A sitting allowance of Rs.70,000 had been paid to the Chairman for attending to the Board Meetings in addition to Chairman allowance for the year under review.
(g) Public Enterprises Circular No. PED 3/2015 of 17 June 2015 - Paragraph 2.1	A sum of Rs.75,000 could be only paid as monthly allowance to the Chairman of the Company. However, the Company had paid a sum of Rs.350,000 per month for the year under review exceeding the stipulated amount.

3. Financial Review

3.1 Financial Results

According to the financial statements presented for audit, the operations of the Company for the year under review had resulted in a pre-tax net profit of Rs.116.0 million as compared with the corresponding pre-tax net profit of Rs.67.6 million for the preceding year, thus indicating an improvement of Rs.48.4 million in the financial result for the year under review. Increase of cold mix sales income by Rs.102 million had been mainly attributed for the improvement in the financial results of the year under review.

3.2 Value Addition of the Company

According to the information provided, the value addition of the Company had increased gradually from the year 2012 to 2016. The value addition for the year under review after taking into account the personal emoluments, depreciation and tax expenses of Rs.45.90 million for the year 2016 was Rs.145.64 million and as compared with the preceding year this was increased by 52 per cent.

3.3 Analytical Financial Review

3.3.1 Significant Accounting Ratios

According to the information made available, some the important accounting ratios of the Company for the year under review as compared with preceding two years are given below.

	2016	2015	2014
Current Assets Ratio	1.62:1	2.24: 1	1.31:1
Quick Assets Ratio	1.61:1	2.23:1	1.30:1
Gross Profit Ratio (%)	43	14	17
Return on Capital Employed (%)	35.19	29.78	33.32

(a) Even though the total comprehensive income of the Company for the year under review had increased to Rs.100 million from Rs. 58 million reported in the preceding year, the net current assets had decreased by Rs. 22.2 million or 15.8 per cent. In the meantime, the total net assets of the Company had increased by Rs. 97.8 million or 42.2 per cent as compared with the preceding year.

(b) Gross Profit Ratio had increased by 43 per cent in the year under review mainly due to increase of sales income by 271 per cent as compared with the preceding two years.

4. Operating Review

4.1 Performance

The main objectives of the Company are to engage in manufacture and supply of emulsion, premix, metal, materials and for providing consultancy services, preparation of BOQs, engineering estimates, project proposals, and services as Project Managers for road sector developers. The physical performance of the Company according to the information provided to audit for the year under review and last two preceding years, are shown below.

	Actual Achievements		
	2016	2015	2014
Supply of Cold mix			
- To RDA (Rs. million)	252.1	69.7	164.4
(Metric tons)	28,888	7,140	16,008
- Other Customers (Rs. million)	17.9	3.0	6.6
(Metric tons)	1,822	273	586
Project Income (Rs. million)	10.49	620.68	413.0
Number of Projects	01	46	19
Transport Income (Rs. million)	45.6	13.9	34.6

The following observations are made in this connection.

(i) Key Performance Indicators (KPI's) had not been set-out by the Company for annual targets. Therefore, it was unable to compare the actual performance with the expected targets in audit.

(ii) Cold mix produced by the Company had been sold mainly to the Road Development Authority (RDA) and it represents 94 per cent, 96.3 per cent and 96.5 per cent out of the total quantity sold in the years 2016, 2015 and 2014 respectively. The Company had carried out 66 Projects during the years from 2014 to 2016. All those Projects had been offered by the Road Development Authority. Accordingly, it was observed that the operating income of the Company is completely depends on the transactions executing with the Road Development Authority.

4.2 Identified Losses

Pay As You Earn tax (PAYE) amounting to Rs. 797,647 which should be recoverable from the salaries and allowances of then Chairman of the Company since 2013 had been written off against the income of the Company according to a Board decision taken on 19 May 2016.

4.3 Assets Management

A fixed asset register had not been maintained by the Company and an annual verification of fixed assets had not been carried out since the commencement of the Company.

4.4 Transactions of Contentious Nature

The following observations are made.

(a) Even though the main source of income of the Company is selling cold mix, there is no proper ordering system for selling the cold mix. The orders are obtained over the phone without being applied documentary confirmation system.

(b) The Company had introduced different prices for the supply of cold mix to the RDA and private sector. The selling price to the RDA is lower than the price impose to private sector. However, action had not been taken to obtain the approval from the Board of Directors for this pricing policy and only the Chairman had given the approval.

4.5 Human Resources Management

The following observations are made.

(a) The actual cadre and the approved cadre (approved by the Board of Directors) of the Company as at 30 May 2017 were stood at 64 and 110 respectively. It was observed that 46 vacancies were existed relevant to 24 posts in the approved cadre.

(b) Four Consultants were appointed during the year under review and salaries and vehicle allowances aggregating Rs. 2,187,500 had been paid from the month of March to December 2016 for those officers. However, available copies of the certificates in the personal files had not been certified as true copies by the authorized officers.

4.6 Procurement Management

The following observations are made.

(a) According to Guideline 2.6 of Government Procurement Guidelines, the Company had not established a Technical Evaluation Committee to support the Procurement Committee and, the members of the Procurement Committee were acting as the members of the Technical Evaluation Committee too.

(b) The Company had called bids for works of interior partition and carpeting of the third floor of the Company building in May 2016. The Board of Directors had recommended the bid price of Rs.12,099,000 including Value Added Tax (VAT) on 08 November 2016. The following matters were revealed in this regard.

   (i) Bids had not collected and opened simultaneously, according to Guideline 1.2.1(f) of the Government Procurement Guidelines.

(ii) Before calling the bids, the Company should prepare an engineer estimate for the works which were expected to be procured. However, the Company had not prepared an engineer estimate and a Bill of Quantity (BOQ) for the renovation works of third floor of the Company building before calling quotations. Hence, the Procurement Committee was unable to compare the quotations presented by the bidders with engineer's estimate in order to make feasible decision. However, the Board of Directors had recommended awarding the contract by considering the quality of other construction works carried out by the respective bidder.

5. Accountability and Good Governance

5.1 Corporate Plan

The following observations are made.

(a) The Corporate Plan of the Company had been prepared without complying with the provisions in Section 5.1.2 of the Public Enterprises Circular No. PED/12 of 02 June 2003, and the Corporate Plan had not been approved by the Board of Directors.

(b) According to Section 5.1.3 of the Public Enterprises Circular No: PED/12 of 2003, updated copies of the Corporate Plan approved by the Board together with the updated Annual Budget should be forwarded to the line Ministry, Department of Public Enterprises, General Treasury and the Auditor General at least 15 days before the commencement of each financial year. However, the Company had not complied with this.

5.2 Action Plan

An Action Plan had not been prepared by the Company for the year under review.

5.3 Internal audit

An Internal Audit Division had not been established by the Company.

5.4 Budgetary Control

(a) Budgeted Statement of financial position, Cash Flow Statement and Budgeted Capital Expenditure together with an Action Plan had not been included in the budget prepared for the year under review in accordance with Section 5.2.1 of the Public Enterprises Circular No: PED/12 of 2003.

(b) Further, significant variances were observed between the budgeted and actual income and expenditure of the Company due to lack of sound and effective budgeting system. As such it was observed that the Budget had not been made use of as an effective instrument of management control.

6. Systems and Controls

Deficiencies observed in the systems and controls of the Company were brought to the notice of the Chairman from time to time. Special attention is needed in respect of the following areas of control.

	Control Area	Observations
(a)	Human Resources Management	Cadre and Scheme of Recruitment and Promotions had not established.
(b)	Accounting	- Non-disclosure of transactions with related parties (transaction with Road Development Authority and Maganeguma Companies) - Non application of requirements in the accounting standards for accounting of fixed assets.
(c)	Internal Auditing	As a part of an internal control system, internal audit functions had not been carried out by establishing an Internal Audit Division.
(d)	Sales	Ordering system for sales had not been followed and there was no approved sales manual to the Company describing sales procedures.
(e)	Receivables and Payables	Long outstanding balances remained in the accounts without being recovered/ settled due to the lack of proper debts/ credit control system.
(f)	Asset Management	- Verification of assets had not been conducted. - Non availability of properly updated Asset Registers.
(g)	Taxation	Maintenance of tax records and tax management procedures were in weak level. As a result, long outstanding tax liabilities were existed.