Land Reclamation and Development Company Limited - 2016

The audit of financial statements of the Land Reclamation and Development Company Limited ("the Company") 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 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 conducting the audit in accordance with Sri Lanka Auditing Standards. Because of the significance of the matters described in Basis for Disclaimer of Opinion paragraph of this report, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

1.4 Basis for Disclaimer of Opinion

(a) The Company holds 100 per cent ownership in LRDC Services (Private) Limited. In accordance with Sri Lanka Accounting Standards, the parent company is required to prepare consolidated financial statements annually. However, The Company has not provided consolidated financial statements for the purpose of audit.

(b) The Company has recorded an amount of Rs. 53,050,416 in relation to construction work in progress as at 31 December 2016. Satisfactory evidence was not made available to verify existence, completeness and accuracy of the balances due to lack of documentary evidence.

(c) During the visit to the factory premises of the Company, it was observed that one machinery which has not been used for the production of the Company due to defects in the output generated. This machine has been purchased in 2014 and has a net book value of Rs. 3,155,600 as at 31 December 2016. However, the recoverable value of the said asset has yet not been determined by the Company and an impairment assessment has not been carried out in this regard.

(d) I noted unidentified differences between the staff loans, festival advances and other loan balances shown in the general ledger and supporting schedules provided by the client as follows;

Name of the Account	Balance as per General Ledger	Balance as per Schedule	Difference
……………	……………….	……………….	………….
	Rs.	**Rs.**	**Rs.**
Staff Loan	3,498,952	3,711,597	(212,645)
Festival Advance	267,121	202,000	65,121
Special Loan	2,941,063	2,447,164	493,899
Other Loans	559,814	-	559,814

Management was unable to provide me with adequate evidence to reconcile the differences noted above and I am unable to determine the existence or completeness of the above mentioned loan receivables shown in the financial statements of the Company as at 31 December 2016.

(e) As noted in accounting policy No 2.4 (a) to the financial statements, the Company has recognized its contract revenue on cash basis. This is not in accordance with Section 23.17 of SLFRS for SMEs, which requires when the outcome of a construction contract can be estimated reliably and entity shall recognize contract revenue and contract costs associated with the construction contracts as revenue and expenses respectively by reference to the stage of completion of contract activity at the reporting period.

(f) An amount of Rs. 210,619 is reflected within Other Receivables relating to an amount of VAT receivable. Such has been carried forward from several years back. Satisfactory evidence was not made available to verify existence, completeness and accuracy of this balance.

(g) In the absence of independent confirmations or other transactional supports/breakups, I am unable to satisfy myself as to the accuracy of following balances reflected in the financial statements as at the reporting date.

Item	Amount
………	……….
	Rs.
Loans due to Sri Lanka Land Reclamation & Development Corporation	(1,200,000)
Amounts due to Sri Lanka Land Reclamation & Development Corporation	(19,685,960)
Amounts due to LRDC Services (Pvt) Ltd	(676,899)
Amounts receivable from Sri Lanka Land Reclamation & Development Corporation	13,488,123
Amounts due to LRDC Services (Pvt) Ltd	24,002

(h) The Company has recorded an amount of Rs. 61,393,884 and Rs. 34,044,266 as long outstanding retention receivables and mobilization receivables respectively as at 31 December 2016. However, satisfactory evidence was not made available to verify existence, completeness and accuracy of the balances.

(i) I have observed a difference between taxable supplies considered in the VAT return and the ledger. As a result, VAT had been underprovided by Rs.9,533,358. Further, satisfactory evidence was not made available to verify existence, completeness and accuracy of the balances. Details are shown below.

Item	Amount
----------	-----------
	Rs.
Total Taxable Supply-As per Return	358,399,142
Total Taxable Supply-As per Ledger	421,954,864
Difference	63,555,722
Tax impact (VAT Rate - 15%)	9,533,358

(j) In accordance with Sri Lanka Accounting Standards, the Company is required to disclose the following;

i. Related party transactions which are a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

ii. Compensation to key management personnel those who are the people having authority and responsibility for planning, directing, and controlling the activities of an entity, either directly or indirectly in total and for each of the following categories: (a) short-term employee benefits; (b) post-employment benefits; (c) other long-term benefits; (d) termination benefits; and (e) share-based payments.

iii. Contingent liabilities which is a potential liability that may occur, depending on the outcome of an uncertain future event and the contingent assets is a potential asset associated with a contingent gain. There were no such disclosures made in the financial statements.

(k) As included in the "Other Matter Paragraph", in my previous year audit report, balance reflected in the financial statements relating to Revenue, Construction work in progress, Receivables, Income Tax Receivables and Related party transactions have been qualified. Nevertheless, I have not been pro*vided with the additional support in establishing the reasonability of balances as at 31 December* 2015, and I am unable to verify the existence, completeness and accuracy of the same.

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the significance of the matters described in Basis for Disclaimer of Opinion paragraph of this report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

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) In my opinion, the financial statements of the Company do not comply with the requirements of Section 148(2) and 151 of Companies Act No.07 of 2007.

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

Instances of non-compliance observed in audit are given below.

Reference to Laws, Rules, Regulations, etc.	Non-compliance
(a) Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka	
Financial Regulation 371	Bank reconciliation statements for a bank current account maintaining at Hatton Branch of the Bank of Ceylon had not been prepared for the month of January to December 2017.

(b)	Public Enterprises Circular No. PED/12 of 02 June 2003. --------------------------------------	
	(i) Section 7.4.5	Annual Boards of Survey and Special Board of Survey had not been appointed to verify the fixed assets of the Company.
	(ii) Section 7.4.1	Audit Committee meeting had not been held on a regular basis at least once in three months.
(c)	Extraordinary Gazette No. 1823/05 of 12 August 2013	The Company had not conducted a formal transfer pricing study with a view to introduce the transfer pricing policy.

3 Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company for the year ended 31 December 2016 had resulted in a pre-tax net profit of Rs.5.7 million as compared with the corresponding pre-tax net profit of Rs.51.4 million in the preceding year, thus indicating a deterioration of Rs.45.7 million in the financial results for the year under review. Decreases of revenue from constructions and workshops in the year under review by Rs.82.4 million were mainly attributed for this deterioration in the financial results for the year under review.

3.2 Analytical Financial Review

3.2.1 Significant Accounting Ratios

According to the information made available, some important ratios of the Company for the year under review and the preceding year are shown below.

	2016	2015
Gross Profit Margin (Percentage)	9.49	15.18
Net Profit Margin (Percentage)	1.36	10.33
Current Ratio (Number of times)	1.37	1.29
Debtors Turnover Ratio (Number of times)	9	10
Debtors Collection Period (in days)	40	33

The following observations are made in this connection.

(a) The gross profit margin of the company had drop to 9.49 per cent in 2016 from 15.18 per cent in 2015 due to decrease of construction revenue and other operating income of the Company by Rs.82.4 million and Rs.5.6 million or 19 per cent and 53 per cent respectively as compared with the preceding year. As a result, the gross profit margin had also significantly decreased in the year under review.

(b) The Debtor Turnover Ratio and Debtors Collection Period were at very weak level, thus indicating that the debt management process of the Company was not in a satisfactory position.

4 Operating Review

4.1 Performance

According to the memorandum of Association of the Company, the primary objectives and main functions of the Company include,

(a) Carry on business activities of an undertaking which will engage itself solely in property development projects approved by the Minister on the recommendation of the Urban Development Authority.

(b) Reclaim and develop any area of land which is either low lying, marshy or swampy and make such areas of land suitable for any building, industrial, manner of reclamation and development project.

(c) Enter into agreements with the Sri Lanka Land Reclamation and Development Corporation in order to take custody, manage and control in whatsoever manner, any lands vested in the Sri Lanka Reclamation and Development Corporation.

(d) Assist in any form and manner of property development and to provide any kind of service, whether for payment of a fee or otherwise, to the Sri Lanka Reclamation and Development Corporation, including to cause the construction of roads, to cause the construction of work for the provision of public services, sewerage and disposal of sewage, lighting and water supply and like.

(e) Construct harbours and anchorages and to undertake work in the field of irrigation, sea reclamation and coastal development.

(f) Carry out building, engineering and construction works including the manufacture of any material required for such building, engineering or construction works.

(g) Undertake consultancy work any consultancy assignments in the field of engineering.

The following observations are made in connection with achieving the above objectives and performing main functions.

(i) Action had not been taken to achieve said objectives other than stated in (e) above.

(ii) According to the information made available for audit, the contribution of Factories and a Workshop (excluding overheads of the Head Office) for the year under review and the previous year are as follows.

Name of the Factory	Contribution	
	2016	2015
	Rs. million	Rs. million
Nawala Factory – Cement Blocks	(12.43)	(16.88)
Nawala Factory – Pre-cast	13.32	8.88
Nawala yard – Workshop	(5.45)	0.92
Kotagala Factory	(0.93)	(0.24)
Ampara Factory	(0.41)	(0.66)
Hambanthota Factory	(1.53)	(2.54)
Hingurakgoda Factory	(0.11)	(0.10)
Trincomalee Factory	0.14	(0.99)

The following observation is made in connection with the contribution of the seven factories and a work shop.

The operation of the five factories out of seven and a workshop for the year ended 31 December 2016 had resulted in a negative contribution of Rs. 20.86 million as compared with the negative contribution of Rs. 21.41 million for the preceding year. Under-utilization of capacities of machinery and human resources was the main reason attributed for these negative contributions.

4.2 Management Weaknesses

The following observations are made

(a) Even though five factories and a workshop of the Company had continuously running at loss due to low productivity and decrease of sales income, the management had not taken necessary actions in order to mitigate the losses.

(b) The Company is being used technologically outdated machineries for it manufacturing process and meanwhile, the Company does not possess any tools or equipment to use in an event of machinery breakdown.

(c) The Company had maintained a fixed working time for its factory employees instead of being introduced a shift working time. Accordingly the present fixed working time of the Company is from 8.00 am to 4.30 pm. As a result, the productivity had declined by considerable amount and also the Company had failed to full fill the prevailing demand in market.

4.3 Operating Weaknesses

As a practice, the Company had sub-contract its most of the construction works to outsiders due to lack of adequate human and other resources without being made arrangements to execute the respective contracts directly. Hence, the lower net margin ranging from 3 per cent to 5 per cent only could have been able to earn by the Company.

4.4 Procurement Process

The following observations are made

(a) The approval for purchase orders, obtaining quotations and making payments to purchase etc. had been done by the General Manager of the Company, without segregation of duties among the officers in proper manner.

(b) The Accountant and the Engineer of the Company were appointed as the members to the both Committees of Technical Evaluation and Procurements, contrary to the provisions in the Government Procurement Guidelines.

4.5 Human Resources Management

The following observations are made.

(a) Scheme of Recruitments and Promotions for each post had not been prepared and obtained the approval to the same from the Board Directors and the Line Ministry in terms of Section 9.1.14 of the Public Enterprises Circular No: PED/12 of 02 June 2003.

(b) Vacancies in some key positions such as Supply Manager, Engineer etc. existed since 2014 had not been filled by the Company even up to 03 July 2017. Hence, it was badly affected the smooth operation of the Company.

(c) It was observed in audit, that the employees involving in construction works had not complied with the health and safety procedures laid down by the Company due to lack of supervision thereon.

4.6 Idle and Underutilized Assets

A cement block machine valued at Rs.3,155,600 purchased in 2014 had been remained at the Nawala Factory without being utilized for intended purpose due to some defects revealed in the outputs.

5 Accountability and Good Governance

5.1 Corporate Plan

A Corporate Plan had not been prepared by the Company in terms of Public Enterprises Department Circular No. PED/12 dated 02 June 2003.

5.2 Procurement Plan

The Company had not prepared a Procurement Plan for the year under review as per the Guidelines in the Government Procurement Guidelines.

5.3 Budgetary Control

An annual budget had not been prepared by the Company in terms of paragraph 5.2 of Public Enterprises Circular No. PED/12 dated 02 June 2003.

6. Systems and Controls

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

Areas of Control	Observations
(a) Accounting	i. The accounting formats in the accounting software which used by the company were not aligned with the reporting formats of the monthly management accounts as required by the Company.
	ii. The Financial Division of the Company had not maintained a formal documented accounting manual for accounting purpose.
(b) Internal Control	i. A formal documented internal control procedures manual was not available in the Company.
	ii. Internal Audit functions had not been carried out as a part of internal control system.