State Engineering Corporation of Sri Lanka – 2016

The audit of financial statements of the State Engineering Corporation of Sri Lanka ("the Corporation") 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 statement of cash flows 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 read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section 29 (2) of the State Industrial Corporations Act, No.49 of 1957. My comments and observations which I consider should be published with the annual report of the Corporation in terms of Section 14(2)(c) of the Finance Act appear in this report.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal controls as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1:3 Auditors' 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 consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000-1810). 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 Corporation'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 Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

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 Adverse Opinion

Had the matters described in paragraph 2.2 this report been adjusted, many elements in the accompanying financial statements would have been materially affected.

2. Financial Statements

2.1 Adverse Opinion

In my opinion, because of the significance of the matters describe in paragraph 2.2 of this report, the financial statements do not give a true and fair view of the financial position of the Engineering Corporation of Sri Lanka as at 31 December 2016 and financial performance and cash flows for the year then ended in accordance with Sri Lanka accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards (LKAS/SLFRS)

The instances of deviation with the following Standards were observed.

(a) LKAS - 01, Presentation of Financial Statements

According to Paragraph No.32 of the Standard, the assets and liabilities, and income and expenditure should not be off set against each other unless required or permitted otherwise by the Sri Lanka Financial Reporting Standards. However, the debit balances in the creditor's accounts, sub-contractor's accounts, accrued and provision accounts, accounts of the creditors of National Equipment and Machinery Organization (NEMO) and mobilization advance received accounts had been off set against the credit balances of those accounts. Hence, the credit balances of such accounts had been understated by Rs.44,316,910, Rs.193,525,178, Rs.101,764,588, Rs.25,191,232 and Rs.309,493,310 respectively.

(b) LKAS- 02, Inventory

According to provisions in the Standard, the stock should be valued at cost or net realizable value, whichever is lower. Nevertheless, the cost of the stocks of finished goods and raw materials as at 31 December 2016 had been valued at 95 per cent of the net realizable value. As such the accuracy of the cost of sales shown in the financial statements could not be relied upon in audit.

(c) LKAS - 16, Property,Plant and Equipment

Fixed assets and software costing to Rs.50,492,060 and Rs.2,723,962 respectively which were fully depreciated had been continuously used without being review economic useful lifetime of such assets. Further, action had not been taken to revise the estimated error in accordance with the Sri Lanka Accounting Standard - 08.

(d) SLFRS– 05, Non-current Assets Held for Sale and Discontinued Operations

Although Crawler Crane and Air Compressor costing to Rs.3,000,000 and Rs.500,000 respectively had been disposed in the year 2017, those assets shown as fixed assets without being categorized as held for sale in the Financial Statements for the year under review.

(e) LKAS–37, Provisions, Contingent Liabilities and Contingent Assets

(i) No provisions had been made in the Financial Statements in respect of the fines imposed amounting to Rs.250,519,976 and Rs.2,598,573 imposed by the Department of Inland Revenue on unpaid Value Added Tax for the year 2013, 2014 and 2015 and Economic Service Charges for the year under review respectively.

(ii) The Diesel Engineering Motor Company (DEMO) had filed a legal case against the Corporation by claiming Rs.96,942,000 with regard to supply of lift to Vehicle Park at work site of the Department of Inland Revenue. However, this had not been disclosed in the Financial Statements for the year under review.

(iii) Further, thirteen legal cases filed against the Corporation claiming to Rs.66,695,475 by the sub-contractors and suppliers had not been disclosed as contingent liability in the financial statements for year under review.

(f) LKAS – 39, Financial Instruments, Recognition and Measurement

(i) Although the loan and receivables should be measured at amortized cost method, trade receivable balance over 5 years amounting to Rs.26,985,543 in NEMO had not been measured at amortized cost method. Hence, there is a possibility to overstate those balances in the financial statements.

(ii) Out of the debtors balance amounting to Rs.39,613,600 belongs to Service Division of the Corporation, a sum of Rs.20,631,145 had remained unsettled for over 05 years. However, no any impairment had been made in respect of those balances.

2.2.2 Accounting Deficiencies

The following accounting deficiencies were observed

(a) Since there were unusual credit balances of Rs.1,770,717, Rs.405,653, Rs.600,320, Rs.6,025,672, Rs.25,535,375, Rs.13,260,041 and Rs.41,610,540 in the ledger account of deposits, pre payments and advances, advance for services, imprest of labor contracts, special cash advances, advances from debtor retention, collections from client at NEMO and other receivables respectively as at the end of the year under review, the value of the respective accounts had been understated by similar amounts.

(b) Since there were an unusual debit balances of Rs.901,123 and Rs.596,400 in the creditor control account (8040) and sub-contractor payable account as at the end of the year under review, those values as at that date had been understated by the said amounts.

(c) An abnormal credit balances totalling Rs.9,755,917 was observed in the individual debtor balance. As a result individual debtor balance had been understated by the same amount.

(d) The expenditure totalling to Rs.12,977,558 incurred by the Divisions of Construction, Construction Component, Mechanical & Electrical and Road & Bridge during the year under review had been shown as negative balances. As a result profit of the year had been understated by Rs.343,905.

(e) The estimated cost of the project had been calculated at 89 per cent of the total project cost instead of being taken the actual estimated cost of the project. Hence, the completion percentage of the project had not been correctly calculated and therefore the profit for the year and the accumulated profit had been overstated and understated respectively.

(f) The value of the land in Ekala with an extent of 13 acres 03 roods and 35 perches vested in the Corporation in terms of Section 44 of the Land Acquisition Act had not been brought to the accounts of the year under review.

(g) The Value Added Tax (VAT) payable balance had been understated by Rs.6,251,229 in the Financial Statements during the year under review due to an accounting error.

(h) The Corporation had over provided for impairment on debtors amounting to Rs.60,656,980 as at 31 December 2016.

(i) The output Tax totalling to Rs.7,695,261 arise from hiring of machinery had not been identified. As a result, the liability on VAT had been understated by similar amount.

(j) The Economic Service Charges amounting to Rs.2,979,078 had not been paid or shown as a liability in the Financial Statements. As a result, the profit for the year under review had been overstated while understanding the liability by the same amount.

(k) The Nation Building Tax (NBT) payable amounting to Rs.1,190,229 for the year under review had not been remitted or shown as a liability in the Financial Statements and as a result, the profit for the year under review had been overstated while understanding the liability by the same amount.

(l) The differed tax assets had been overstated by Rs.1,149,661 during the year under review. Details are as follows.

	Rs.
The differed tax assets as per the Financial Statements	156,390,341
The differed tax assets as per the calculation of audit	155,240,680
Overstatement of Differed Tax Assets	1,149,661

(m) The land valued at Rs.7.2 million owned to the Seruwawila Rajamaha Viharaya had been brought to the Financial Statements for the year under review. As a result, the value of land shown in the financial statements had been overstated by same amount.

(n) Although the land and building valued at Rs.115.21 million shown in the Financial Statements were not belongs to the NEMO, the accumulated depreciation thereon amounting to Rs.3,231,000 and depreciation of Rs.807,750 had been made in the Financial Statements of the Corporation for the year under review.

(o) The building amounting to Rs.1,293,933 and Plant, Machinery and Equipment amounting to Rs.28,000,772 received as grant had been dismantled during the year under review. However it had not been disposed. The cost of Rs.29,294,705 and accumulated depreciation of amounting to Rs.13,661,882 respectively of those assets had been removed from the Financial Statements. As a result cost and accumulated depreciation of building and Plant, Machinery and Equipment were understated by the same amount in Financial Statements in the year under review.

(p) The concrete slippers amounting to Rs.9,456,048 rejected by the Department of Railway had been remained in the stocks for over 05 years. The impairment of 25 per cent or Rs.2,364,012 only had been made thereon during the year under review. As a results, the value of stocks had been overstated by Rs.7,092,036 in the Financial Statements in year under review. Further an un-salable finished goods valued at Rs.2,647,130 remained in the Ekala site had not been impaired.

(q) The impairment had not been provided for raw material stocks valued at Rs.62,238,799 remaining long period of time at NEMO. As a result, the fair value of raw material stocks had not been reflected in the Financial Statements for the year under review.

(r) Since there was an abnormal credit of Rs.1,224,809 in the deposits account at the end of the year under review, the balance in the deposit account had been understated by that amount.

2.2.3 Unexplained Differences

The following observations were made.

(a) A difference of Rs.62,370,433 was observed between the Inter group balance shown in the Financial Statements of the Corporation and NEMO. Further, out of current account balance of Rs.451,366,524 shown in the NEMO, a sum of Rs.406,473,523 remained as opening balance. The detail of that balance had not been furnished to audit.

(b) A difference of Rs.216,068,743 was observed between the payable balance shown in the financial statements of the National Housing Development Authority and the Corporation.

(d) An unidentified deposit balance of Rs.1,328,759 relating to the period of 2012 to 2015 remained in the Financial Statements of NEMO without being identified.

(e) The VAT payable consists the opening debit balance Rs.16,312,677. The reasons for this had not been furnished to audit.

(f) An unidentified deposit account balance of Rs.3,351,644 had remained in the Financial Statements in the year under review without being taking actions to identify.

(g) The cost of concrete mixture (CM 02) purchased during the year under review had been shown in the Financial Statements as Rs.850,000. However, it had been shown in fixed asset register as Rs.650,000. Hence, an unexplained difference of Rs.200,000 was observed.

(h) Although the Plant and Machinery Equipment valued at Rs.696.31 Million and vehicle valued at Rs.39.34 million received as Grant, the details thereon had not been shown in the fixed assets register.

(i) As per the stock verification done for pre cast yard at Ekala (Site No 237), there is a shortage of stock totalling Rs.5,026,576 an excess stock amounting to Rs.3,295,165 was identified. The reasons had not been furnished to the audit.

(j) Even though the cost of the two bowsers shown in the fixed assets register as Rs.530,000 , it had been brought to the financial statements as Rs.567,000. An unexplained difference of Rs.37,000 was observed.

(k) Even though the cost of the two tractor tailor shown in fixed asset register as Rs.330,000 and Rs.242,000, it had been brought to the financial statements as Rs.348,500 and Rs.265,000. An unexplained differences of Rs.18,500 and Rs.23,000 were observed.

(l) The value of 1507 items of Slippers shown in financial statements of 2014 was Rs.8,958,361. However, such stocks inventories shown in financial statements year under review as Rs.9,456,048. The evidence for such increment of the inventories was not made available.

2.2.4 Lack of Evidence for Audit

Evidences indicated against each of the following items were not made available for audit.

	Item of Account	Value Rs.	Evidence not made available
(a)	Cash advance opening balance	4,881,229	Schedules and Age Analysis
(b)	Debtor balance - NEMO	14,031,470	Age Analysis
(c)	Opening balance of sub-contractor payable	39,073,341	Detail Schedules
(d)	GST Payable	9,594,208	Detail Schedules
(e)	Nation Building Tax Out put	7,820,468	Detail Schedules
(f)	Other Tax Payable	1,766,402	Detail Schedules
(g)	Deposit receivable balance	11,839,770	Age Analysis
(h)	Due to Customer balance	543,921,906	Detail Schedules
(i)	Accumulated depreciation of fixed assets NEMO	118,245,087	Detail Schedules

2.3 Accounts Receivable and Payables

The following observations were made.

(a) The net retention balance of Rs.772,972,662 had remained unrecovered for over 05 years. Further, the retention balances over Rs.5 million totalling to Rs.896,200,501 had remained for over 05 years.

(b) The opening balance of cheque with order advance amounting to Rs.8,956,071 had remained in the accounts without being settled.

(c) The balance of foreign purchases control account amounting to Rs.13,734,094 had remained since the year 2012 without being recovered in Service Division and opening balance of foreign purchases control account Rs.29,968,288 in Mechanical & Electrical Division had also not cleared even upto the end of the year. The details of those balances had not been furnished to the audit.

(c) The creditor balances over Rs. 01 million totalling Rs.255,388,399 had remained for over 05 years without being settled.

(d) According to the age analysis presented the mobilizations advances received from the clients for over 5 years was amounted to Rs.182,345,510 remained without being recovered.

(f) Out of the advance balance for other services amounting to Rs.1,282,099 belongs to NEMO, a sum of Rs.501,763 had remained over 03 years.

(g) Out of labor contract account amount of Rs.13,088,124 shown in the Financial Statements of the NEMO, a sum of Rs.3,355,324 had remained over 03 years.

(h) Out of the retention money receivables balance of Rs.33,182,436 an amount of Rs.16,425,111 had remained from the year 2013 without being recovered.

(i) Special cash advance balance of Rs.2,419,867 and deposits repayable account balance of Rs.3,196,096 had remained in Financial Statements since the year 2013 without being recovered or settled.

2.4 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance were observed in audit.

	Reference to Laws, Rules Regulations and Management Decisions etc.	Non-compliance
(a)	Value Added Tax Act No.14 of 2002	Action had not been taken to remit the Value Added Tax totalling Rs.46,823,823 relating to year under review.
(b)	Nation Building Tax Act No. 09 of 2009	Action had not been taken to remit the Nation Building Tax totalling Rs.1,193,334 relating to year under review.

(c)	Section 02 of the Economic Service Charge Amendment Act No. 13 of 2006	The Institutions generating the income more than Rs.50 million per quarter, should pay the Economic Service Charges equivalent at 0.5 per cent of the income not exceeding Rs.30 million per quarter. However, the Economic Service Charges amounting to Rs.2,979,078 payable as per the computation of the audit in respect of the income earned by the Corporation in the year 2016 amounting to Rs.595,815,627 had not been remitted to the Department of Inland Revenue.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Corporation during the year under review had resulted in a post-tax net loss of Rs.904,479,014 as compared with the corresponding pre-tax net loss of Rs.744,581,777 for the preceding year, thus indicating a severe deterioration of Rs.15,966,127 in the financial results for the year under review. Increase of interest expenditure by Rs.44,819,242,increase of administrative expenditure by Rs.150,310,378,decrease of other income by Rs.181,870,344 and increase of finance cost by Rs.50,544,183 were the main reasons attributed for this situation.

3.1.1 Value Addition of the Corporation

The detail of value addition of the Corporation from 2012 to 2016 as follows.

	2016	**2015**	**2014**	**2013**	**2012**
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Profit/(Loss) after Tax	(904,479,014)	(744,581,777)	74,534,988	122,726,033	204,121,567
(+) Employee Benefit	227,564,599	188,769,676	165,177,185	175,236,245	105,922,244
Tax Paid - VAT	78,839,708	79,009,022	154,211,263	223,179,026	292,982,089
- ESC	-	-	-	-	13,039,101
- NBT	7,479,913	5,255,365	6,870,861	7,904,555	6,337,719
Depreciation	252,023,956	253,333,230	250,696,182	131,318,279	66,472,758
Value addition of the Corporation	(338,570,838)	(218,214,484)	651,490,479	660,364,138	688,875,478

The value addition of the Corporation had been deteriorated from the year 2012 to 2014 and after that it had shown abnormal negative results up to the year under review.

3.2 Analytical Financial Review

3.2.1 Profitability

An analysis on the financial results of the year under review and four preceding year revealed that there was a surplus in the year 2012,but it had gradually deteriorated since the year 2012 to the year under review. As such, the surplus of the year 2012 amounting to Rs.204,121,567 had become a deficit of Rs.904,479,014 by the end of the year under review. Details are shown below.

	2016 Rs.	2015 Rs.	2014 Rs.	2013 Rs.	2012 Rs.
Revenue	2,680,642,996	3,168,016,408	7,403,418,660	7,965,731,512	7,951,205,894
Gross Profit	(747,945,689)	(799,394,028)	195,346,353	522,549,676	653,919,737
(-) Administrative Expenses	(423,964,951)	(273,654,573)	(388,165,985)	(424,107,378)	(439,624,663)
Operational Profit/Loss	(1,171,910,640)	(1,073,048,601)	(192,819,632)	98,442,298	214,295,074
(+) Other Income	244,566,731	426,437,075	299,423,834	121,717,774	25,910,734
(-) Net Finance Income / (Expense)	(112,768,542)	(62,224,359)	(59,998,458)	(71,587,241)	(14,297,253)
Profit / Loss before Tax	(1,040,112,451)	(708,835,885)	46,605,744	148,572,831	225,908,555
(-)Taxes	135,633,437	(35,745,892)	27,929,244	(25,846,798)	(21,786,988)
Profit/Loss after Tax	(904,479,014)	(744,581,777)	74,534,988	122,726,033	204,121,567

The following observations are made in this regard.

(a) Administrative Expenses had increased by 35 per cent as compared with the preceding year.
(b) Other Income had decreased by 42.64 per cent as compared with the preceding year.
(c) Net Finance expense had increased by 44.82 per cent as compared with the preceding year.
(d) Loss before tax had increased by 31.85 per cent as compared with the preceding year.
(e) Loss after tax had increased by 17.67 per cent as compared with the preceding year.

3.2.2 Accounting Ratios

Some of the significant accounting ratios for the year under review is as follows.

Accounting Ratio	2015 Percentage	2016 Percentage
Gross Profit Ratio	(25.23)	(27)
Net Profit Ratio	(22.37)	(38.8)

Administrative Expenditure on turn over	8.64	15.81
Net Financial Expenditure on turn over	1.96	4.20
Current Ratio	0.98	0.94
Quick Ratio	0.92	0.88

(a) As compared with the preceding year, the gross profit ratio had been deteriorated by 7 per cent.

(b) As compared with the preceding year, the net profit ratio had been deteriorated by 72 per cent.

(c) As compared with the preceding year, the current ratio had been decreased from 0.98 to 0.94 whilst the quick ratio had decreased from 0.92 to 0.88.