State Development and Construction Corporation - 2017

The audit of financial statements of the State Development and Construction Corporation ("the Corporation") for the year ended 31 December 2017 comprising the 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 read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 29 (2) of the State Industrial Corporation 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 control 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 opinion.

1.4 Basis for Qualified opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of State Development and Construction Corporation as at 31 December 2017 and its 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 Adherent with Sri Lanka Accounting Standards (LKAS/SLFRS)

The following observations are made.

(a) **SLFRS 10 - Consolidated Financial Statements;** Even though an investment of Rs.9,210,740 was made in the Devcoshowa (Private) Ltd which is a fully owned Subsidiary of the Corporation, a consolidated financial statements had not been prepared by the Corporation for the year under review. Further, a debtor balance of Rs.34,802,842 shown in the financial statements of the Corporation as receivable from this Subsidiary. However, there is no documentary evidence made available for audit in order to confirm this balance.

(b) **LKAS 01- Presentation of Financial Statements:** Mobilization advances having debit balance of Rs.5,801,279 and debtors having credit balance of Rs.50,990,962 had been offset against the corresponding credit balances and debit balances respectively as at 31 December 2017 contrary to the provisions in the Standard.

(c) **LKAS 16 – Property, Plant and Equipment:** Since failed to review the useful economic lifetime of non-current assets annually as mentioned in the Standard, 42 items of office equipment, 07 motor vehicles and 54 items of machinery costing Rs.2,318,571, Rs.3,558,000 and Rs.43,623,436 respectively are being continuously used although they were fully depreciated. Accordingly, action had not been taken to revise the error in the estimates. Further, 93 items of machinery and a motor vehicle which cost not furnished to audit are being continuously used although they were fully depreciated.

(d) **LKAS 39 - Financial Instrument Recognition and Measurement;** Balances of trade and other receivable totaling Rs.188,544,980 had not been considered for impairment. Hence, these balances had not reflected at fair value in the financial statements.

2.2.2 Accounting Deficiencies

The following accounting deficiencies were observed.

(a) According to the assessments received from the Department of Inland Revenue up to 2015 an amount aggregating Rs.115,003,889 had to be paid as surcharge on Value Added Tax (VAT) as at the end of the year under review. However, no provision had been made in this regard in the financial statements for the year under review.

(b) Debit balances aggregating Rs.23,598,467 had been included in the accrued expenses shown in the financial statements for the year under review. As a result, the accrued expenses had been understated by same amount.

(c) An abnormal credit balance of Rs.6,533,077 was observed in the debtor balance due non availability of certified bills although the clients had settled the dues.

(d) Payables of Economic Service Charge (ESC) and surcharges had been understated by Rs.37,635,363 due to error computation. Further, penalty on ESC payable amounting to Rs.2,182,836 for the assessment year 2014/2015 had not been accounted for.

2.2.3 Unreconciled Differences

The following differences were observed.

(i) A deference of Rs. 825,850 was observed between the balance shown in the VAT control account and VAT payable schedule submitted for audit.

(ii) According to the assessment made by the Department of Inland Revenue dated 25 July 2016, the penalty on VAT was Rs.115,003,889. However, according to the schedule submitted to audit it was shown as Rs. 28,849,344. Hence, a difference of Rs.86,154,545 was observed between those two figures.

(iii) The differences of Rs. 5,182,912 was observed between the sundry advances, tender deposits, other deposits, deposits in the Ceylon Electricity Board and impairment of debtors shown in the financial statements and the corresponding balances shown in the respective schedules submitted for audit.

2.2.4 Lack of Evidences for Audit

The following evidence as indicated against the each item of account shown below had not been made available for audit.

	Item of Account	Value Rs.	Evidence not made available
(a)	Withholding Tax	135,044,649	Copies of the Withholding Tax Certificates
(b)	VAT Balances	561,047,472	Schedules and Age Analysis
(c)	Opening Balance of NBT	5,335,464	-do-
	Total	**701,427,585**	

2.2.5 Accounts Receivable and Payable

The following observations are made.

(a) It was observed that out of the trade debtor balance of Rs.352,833,031 receivable from clients as at 31 December 2017, a sum of Rs.25,212,161 and Rs.27,938,734 had remained outstanding between 01 to 05 years and over 05 years respectively.

(b) Out of balances in purchase advances, construction advances and sundry advances aggregating Rs.70,717,854, a sum of Rs.11,675,971 had remained outstanding for over 05 years without being settled.

(c) Mobilization advances received from clients amounting to Rs.19,191,990 and Rs.9,447,187 had remained outstanding for over four years and six years respectively as at 31 December 2017.

(d) Out of retention money amounting to Rs.503,047,861 shown in the financial statements, an amount of Rs.100,916,486 relating to 38 completed projects had remained outstanding for over a period of five years. Further, retention money relating to 40 projects totaling Rs.39,347,662 remained outstanding for a period of over 3 years. Although 8 Projects had been mutually terminated, the balances of retention money totaling Rs.21,408,189 had remained unrecovered as at 31 December 2017.

(e) Out of liquidated damages receivable totaling Rs.157,934,872 from the clients, a sum of Rs.107,304,615 had remained outstanding over four years as at 31 December 2017 without being taken actions to recover those amounts.

(f) The accrued expenses amounting to Rs.310,744,601 had remained outstanding for over three years without being settled. Hence, the accuracy and reliability of these expenses were doubt in audit.

(g) According to the financial statements for the year under review, a loan balance of Rs.20,800,000 and interest thereon amounting to Rs.93,511,060 was payable to the Construction Guarantee Fund as at 31 December 2017. However, no meaningful action had been taken to settle these outstanding balances.

(h) Value Added Tax (VAT) relating to the period of 2002 to 2017 totaling Rs.717,253,475 and penalty thereon amounting to Rs.28,849,344 and Nation Building Tax amounting to Rs.7,144,502 and surcharges thereon amounting to Rs.953,141 had not been remitted to the Department of Inland Revenue even up to the end of the year under review.

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

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

	Reference to Laws, Rules Regulations and Management Decisions etc.	Non-compliance
(a)	Section 02 of the Economic Service Charge (Amended) Act, No: 13 of 2015	Economic Service Charge (ESC) and surcharges thereon amounting to Rs.28,371,278 and Rs.13,654,032 respectively for the year ended 31 December 2017 had not been remitted.
(b)	Financial Regulation 396 of the Government of the Democratic Socialist Republic of Sri Lanka	Action had not been taken in respect of 06 unrealized cheques and un-presented cheques valued at Rs.1,725,909 and Rs.1,533,131 respectively which were remained unrealized and un-presented for over 6 months.
(c)	Management Audit Circular No: DMA/2009(2) Dated 01 July 2009	Required Details had not been included in the Assets Register.
(d)	General Treasury Circular No. IAI/2002/02 Dated 28 November 2002	Separate fixed assets register had not been maintained for Computers Accessories and Software.

3. Financial Review

3.1 Financial Results

Operations of the Corporation during the year review, had resulted in a pre-tax net profit of Rs.12,206,658 as compared with the corresponding pre-tax net profit of Rs. 22,841,652 for the preceding year, thus indicating a severe deterioration of Rs.10,634,994 in the financial results for the year under review. Increase of interest expense for bank overdraft, employee benefit expenses and provision for impairment were the main reasons attributed for this situation.

3.1.1 Value Addition of the Corporation

The value addition made by the Corporation has been gradually decreased since the year 2015. Accordingly, the value addition of Rs. 950,461,143 reported in the year 2015 was decreased to Rs. 895,895,814 in the year 2016 and Rs. 795,648,070 in the year 2017 after taking into account the employee benefits, tax expenses and depreciation charged to the accounts.

3.2 Analytical Financial Review

3.2.1 Significant Accounting Ratios

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

Ratios	**2017**	**2016**
	(Percentage)	**(Percentage)**
Gross Profit Margin	7.37	12.78
Profit mark up	1.08	1.08
Administrative Cost to Turnover	8.39	9.48
Finance Cost to Turnover	5.05	4.58
Current Assets Ratio	1.10	1.04
Acid Test Ratio	1.01	0.9

(i) Although gross profit margin had decreased by 5.41 per cent as compared with the previous year, the net profit margin had decreased only by one per cent.

(ii) The administrative cost and finance cost to turnover had decreased by 1.14 per cent and 23 per cent respectively as compared with the previous year.

4. Operating Review

4.1 Performance

4.1.1 Planning

Manufacture and sales in Sri Lanka or abroad of concrete, reinforce concrete and pre-stressed concrete product required for engineering undertakings is the one of main objective of the Corporation. However, according to the budgeted estimate and the progress report of the Corporation, the following targets with regard production and sales set out to be achieved in the year under review had not been achieved as expected.

(i) **Production 2017**

Name of Yard	Planned	Actual	Not Achieved
	Rs.	Rs.	Rs.
Rathmalana	153,486,720	135,584,764	17,901,956
Bopitiya	169,111,995	85,884,060	83,227,935
Weragantota	130,815,600	90,177,205	40,638,395
Medawachchiya	Not programed	36,828,574	-
Total	**453,414,315**	**348,474,603**	**104,939,711**

(ii) Sales 2017

Name of Yard	Planned	Actual	Not Achieved
	Rs.	Rs.	Rs.
Rathmalana	200,000,000	136,581,369	63,418,631
Bopitiya	125,000,000	72,912,122	52,087,878
Weragantota	125,000,000	78,771,952	46,228,048
Medawachchiya	50,000,000	34,763,072	15,236,928
Total	**500,000,000**	**323,028,515**	**176,971,485**

4.1.2 Construction Contracts

Investigation, investment, planning, designing, construction operation and management of building, civil engineering, other engineering projects or other ventures in Sri Lanka or abroad is the primary objective of the Corporation. The activities performed by the Corporation in order to achieve this objective are given below.

(a) The construction contract of Land Slide Disaster Protection Project had been handed over to the Corporation by Road Development Authority and it was expected to construct of Countermeasures at ten locations in Central, Uva and Sabaragamuwa

Provinces. The commencement date of the project was on 24 March 2017 and it should be completed on 22 March 2019 i.e. within 728 days. The Corporation had given this works to the Italian company as a sub-contract. The following weaknesses were revealed in this regard.

(i) Although the total value of the project was Rs.1,931 million, the works valued at Rs.140 million or 6.8 per cent of the total works only had been completed up to 30 April 2018. Therefore, the possibility of completing the balance works to the value of Rs.1,791 million within next 11 month was doubt in audit. The consultant of the project also informed that the capacity of the sub-contractor was not adequate to complete the works within the agreed time period.

(ii) The Corporation had not obtained the performance bond to the value of 10 per cent of the contract value from the sub-contractor according to the conditions in the letter of acceptance.

(iii) The financial strength and technical strength of the sub-contractor had not been evaluated by the Corporation in selecting the sub-contractor. Further, the inadequate supervision and project management affected to the low progress of the project.

(b) The renovations of the Cardiology Unit of the General Hospital had been handed over to the Corporation by the Ministry of Health on 02 December 2015 and it had to be completed by 10 July 2016. The following observations are made in this regard.

(i) The renovation works had not been completed even up to 09 April 2018. The Director of the General Hospital had informed to the Corporation that the Hospital is facing severe problems due to delaying the renovations.

(ii) The Corporation had failed to enter into a contract agreement with the Ministry of Health in terms of Guideline 8.9.1 of Procurement Guidelines.

(c) Six contracts projects to the total value of Rs.65,124,932 had been abandon without performing the works and reasons for that had not been furnished to audit.

4.2 Operating Inefficiencies

The following observations are made.

(a) Rathmalana and Madawachchiya Concrete Yards had sustained a net loss of Rs.23.6 million and Rs 2.1 million respectively in the year under review though they were reported net profit of Rs.20 million and Rs.3.2 million respectively in the previous year.

(b) The orders received for supply of goods should be fulfilled during the year which the orders received. However, orders to the value of Rs.71,598,000 received for supply of concrete products in previous year and during the year under review had not been fulfilled up to the date of audit on 30 July 2018.

(c) The turnover and gross loss of the Amitirigala Asphoalt Site for the year under review were Rs.47.56 million and Rs.6.7 million respectively. However, these were 2969 per cent decrease as compared with the previous year.

(d) A gross loss of Rs.10,200,719 was sustained by the Polonnaruwa Asphalt Site during the year under review due to no operation carried out during the under review by this Site. In the meantime, a gross loss of Rs.6,937,591 was reported at the Bopitiya crusher plant during the year under review

4.3 Weaknesses in Financial Management

The following observations are made.

(a) The Corporation had obtained an aggregated overdraft facility of Rs.908 million as at the end of the year under review due to absence of proper debt recovery mechanism and working capital management. However, as per the Notification No: PED/COP/15(56)/GEN/VOL–I dated 01 July 2013 issued by the Department of Public Enterprises, the approved overdraft facility was only Rs.580 million. Further, these overdraft facilities had not been used for the operational activities of the Corporation during the year under review due to fully utilized in previous year. Nevertheless, an interest amounting to Rs.111.6 million had been paid in respect of those bank overdrafts during the year under review.

(b) Notwithstanding the existence of bank overdraft of Rs.908,175,280 as at 31 December of the year under review, fixed deposits and saving deposits of Rs.67,526,650 and Rs.116,028,219 respectively had also been maintained by the Corporation.

4.4 Management Activities

The following observations are made.

(a) According to the financial statements of the Fujima State Corporation (Pvt) Ltd, (a Joint Venture Company of the corporation) the amount receivable to the Corporation as at 31 March 2010 was Rs. 41,899,490 and no transactions had been taken place thereafter. However, no action had been taken by the management of the Corporation to recover the dues.

(b) The cost incurred for payment of overtime had been increased by Rs.25 million or 41 per cent during the year under review as compared with previous year.

(c) In some instances the approval for variation and the extra works done had not been obtained from the clients by the Corporation. As a result, the Corporation could not be taken actions against the clients when they were defaulted the payments for such works done.

4.5 Irregular Transactions

The following observations are made.

(i) Out of the cash fraud of Rs.633,414 committed in Bopitiya Concrete Yards in the year 2014, only Rs.268,000 had been recovered from the respective parties and no actions had been taken to recover the balance amount.

(ii) The Corporation had given a cheque advance of Rs.739,000 to an officer attached to the Mechanical Division for purchase of spare parts to the Corporation for the year 2017. Subsequently, this cheque was irregularly encashed by him without purchasing the particular spare parts. However, no actions had been taken against this officer by the Corporation as per Section 5.3 of Chapter XLVII of the Establishment Code of the Democratic Socialist Republic of Sri Lanka.

4.6 Idle and Underutilized Assets

(a) Out of the asphalt plant received from the Ministry of Economic Development, one plant valued at Rs.101 million had been located at Polonnaruwa and the production capacity of that plant is 600 Mt asphalt per day. However, this plant and the relevant accessories there to remained idle due to discontinuation of production after 2014. Further, the Corporation had spent a sum of Rs.1,748,322 as wages and security expenses during the year under review.

(b) The main stores at Rathmalana of the Corporation only utilized for stock of small quantity of vehicle spare parts. The major area of the main stores remained idle.

4.7 Identified Losses

A loss of Rs.115,210,487 had been sustained to the Corporation due to exceeding the cost of the contracts than contract value of 11 projects.

4.8 Personnel Management

The following observations are made.

(a) The approved cadre as at 31 December of the year under review stood at 489 and the actual cadre stood at 654. Accordingly, there were 165 employees excessively recruited by the Corporation to the various posts.

(b) Employees had been recruited on contract basis from time to time including officers of the top management. Accordingly, 02 posts representing senior management had been recruited on contract basis during the year under review. Therefore, it had directly affected to the performance of the Corporation. Further, 111 vacancies in approved posts had remained vacant up to 31 December 2017.

(c) In terms of Management Services Circular No. 28 (ii) dated 01 August 2006 and as per the provisions laid down in Paragraph 1.2 of Volume II of the Establishment Code, creations of posts and filling of vacancies shall not be done without the approval of the Department of Management Services. Nevertheless, 168 contract basis employees and 61 casual employees had been recruited for those posts.

(d) Scheme of Recruitments and Promotions had been prepared and approved only for the managerial and lower level posts. Further, According to the Management Services Circular No. DMS/E3/43/4/268/I dated 17 May 2012, posts in MM 1-2 category had been promoted to HM -1-2 except the Post of Chief Internal Auditor. Post of JM 1-1 category had been promoted to MM 1-2 category except the Post of Internal Auditor. Reasons for that had not been explained to audit.

(e) Five employees had been released to the Ministry of Housing and Construction. According to the Public Enterprises Circular No. PED 12 of 02 June 2003, salaries of those employees should be reimbursed from relevant institutions. However, salaries of Rs.2,061,545 paid those employees for the year 2017 had not been reimbursed.

5. Accountability and Good Governance

5.1 Corporate Plan and Action Plan

The following observations are made.

(a) According to the Public Finance circular No. PFD/RED/01/04/2014/01 of 12 February 2014, the Corporate Plan for the period covering 2017 – 2021 had not been prepared.

(b) Although, an Action plan for the year under review had been prepared by the Corporation. The following weaknesses were observed in that Action Plan.

(i) A Human Resources Development Plan and Internal Audit Plan had not been included.
(ii) Annual Procument Plan Including proposed major investments capacity building and major procument had not been included
(iii) Loan repayment plan had not been included

(iv) Only financial target were given to each Division without including commercial activities to be implemented in the financial year.
(v) Requirement of resources had not been identified in order to accomplish the targets.

5.2 Budgetary Control

Significant variances were observed between the budgeted and the actual income and expenditure thus indicating that the budget had not been made use of as an effective instrument of management control.

5.3 Procurement Plan

Procurement Plan for the year 2017 had not been prepared.

6. Systems and Controls

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

Areas	Observations
(a) Accounting	(i) Failure to adhere with Sri Lanka Accounting Standards. (ii) Un-accounted of taxes payable and surcharges thereon. (iii) Failure to reconcile control accounts and submit the financial statements on due dates.
(b) Control over Receivables and Payables.	(i) Poor control over debtors. (ii) Gradually increase of Government debts. (iii) Prevailing long outstanding debtors. (iv) Considerable delays in submission of invoices to relevant clients. (v) Long outstanding purchase and mobilization advances construction retentions and taxes and surcharges thereon.
(c) Personnel Management	(i) Releasing of human resources to other institutions. (ii) Recruitment of employees exceeding the approved cadre. (iii) Recruiting officers to the senior management post on contract basis.
(d) Assets Management	(i) Idling asphalt plant at Polonnaruwa since 2014. (ii) Failure to acquire the ownership of all lands even as at the end of the year.
(e) Financial Management	Obtain bank overdraft facilities to remediate short term financial issues exceeding the approved limits due to poor working capital management
(f) Procurement Process	Unavailability of Master Procurement Plan and delay in preparing of Annual Procurement Plan.
(g) Inventory Control	(i) Non maintenance of Bin Cards for the stock items. (ii) Un-executed the reconciliations for differences between the physical stock balance and ledger stock balance reported in each and every site. (iii) Failure to adopt proper quotation calling system especially for the spare parts of machineries and vehicles.