

Central Engineering Services (Private) Ltd - 2023

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the Central Engineering Services (Private) Ltd Company for the year ended 31 December 2023 comprising the statement of financial position as at 31 December 2023 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 material accounting policy 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 provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, except for the effects of the matters described in paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2023, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Qualified Opinion

My opinion is qualified on the matters described in paragraph 1.5 of this report.

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 believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified 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 Company'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 Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company 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 Company.

1.4 Audit Scope (Auditor's Responsibilities for the Audit of the Financial Statements)

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 skepticism 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 Company'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 Company'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 auditor's report. However, future events or conditions may cause the Company 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 Company, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and
- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Audit Observations on the preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standards

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(a) As per Section 51 of Sri Lanka Accounting Standards 16, the useful economic life of the property, plant and equipment with a written down value of Rs.378.08 million as on 31 December 2023 had not been reviewed annually.	Assets are planned to be assessed segmentally.	Should be complied with Sri Lanka accounting standards.
(b) The cost of Rs.18.02 million chicks had been purchased as on 31 December 2023 under the Rambakanoya project. Although it should be shown under biological assets, it had been shown under property, plant and equipment contrary to paragraph 12 of Sri Lanka Accounting Standards 41.	I emphasize that in the coming financial year, all biological assets will be disclosed at fair value according to Sri Lanka Accounting Standards No. 41.	Should be complied with Sri Lanka accounting standards.

1.5.2 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
The financial statements had been prepared without being eliminated the internal transactions aggregating Rs.159.9 million incurred between the sub-units of the Bases and the main Bases. Further, an amount of Rs.56.78 million earned from the internal transactions between the Base Offices had been included in the annual income as well as expenditure of the Company.	Due to the limited time available to prepare the financial statements, it is not possible to eliminate certain items. Balance sheet related balances are expected to be investigated during this year and eliminated accordingly.	Transactions and balances between Base offices and divisions should be eliminated in the preparation of financial statements.

1.5.3 Unreconciled Control Accounts or Records

Item	as per Financial Statements	As per corresponding Record	Difference	Management Comment	Recommendation
	Rs. Million	Rs. Million	Rs. Million		
Trade debtors	1,286.66	1,299.37	12.71	Reasons such as not comparing the invoices correctly in the preparation of the final accounts have contributed to this.	Action should be taken to reconcile the balances due and payable to related parties.
Retention receivables	2,027.33	2,080.10	52.77		
Sundry debtors	13.30	-	13.30		
Mobilization advances	3,449.91	3,466.37	16.45		

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
(a) According to the statement of financial position as on 31 December 2023, the total debtor balance was Rs.2,397 million, out of that Rs.401.63 million and Rs.67.08 million were outstanding for the period of 03 to 05 years and more than 05 years respectively.	In this regard, actions are taken constantly from the head office as well as from the respective base offices.	Effective measures should be taken to promptly recover the outstanding balances.
(b) Retention receivable as on 31 December 2023 was Rs.2,962.35 million, out of this, retentions related to completed projects were Rs.659.28 million. Out of that Rs.127.78 million and Rs.158.02 million remained outstanding between 3 to 5 years and more than 5 years respectively, due to non-taking of proper recovery measures by the responsible officials.	In this regard, actions are taken constantly from the head office as well as from the respective base offices.	Effective steps should be taken to recover the outstanding retention balances without delay.

1.6.2 Payables

Audit Issue	Management Comment	Recommendation
As on December 31, 2023, the creditors and retentions payable were Rs.1,651.30 million and Rs.766.08 million respectively. As per the age analysis submitted for audit, the creditor balance shown under current liabilities amounting to Rs.748.33 million was remained unsettled for the period from 02 to 05 years.	After receiving the retention amounts due from the customers, the retention payments due will be made.	The outstanding balances should be settled promptly.

1.7 Related Parties and Related Party Transactions not disclosed

Audit Issue	Management Comment	Recommendation
The Company has to be paid an amount of Rs.1,545.96 million to the parent company Central Engineering Consulting Bureau (CECB) as at 31 December 2023, and the Company had not maintained proper and updated agreements regarding these transactions since inception of the Company and also had not taken any effective action to settle this balance. Therefore, this balance has been continuously increasing since the year 2017.	Long-term balances payable to the parent company are in the process of being reviewed to identify a method of capitalizing those balances.	Clear agreements should be made for the transactions between the company and the bureau and steps should be taken to disclose and settle the relevant outstanding balances.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
Public Enterprises Circular No. 01/2021 dated 16 November 2021 on Operational Manual for Good Governance for State-Owned Enterprises			
Paragraph 3.2 (i)	An approved recruitment procedure had not been prepared for the staff of the company as on 31 March 2024.	Referred to the approval of Department Management Services.	The scheme of recruitment and promotion should be approved expeditiously.

2 Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs.383.3 million and the corresponding loss in the preceding year amounted to Rs.58.4 million. Therefore, a deterioration amounting to Rs.324.9 million of the financial result was observed. The reasons for the deterioration was mainly due to an increase in selling and administrative expenses by Rs.798 million despite an increase in revenue of Rs.522 million compared to the previous accounting period.

2.2 Trend Analysis of major Income and Expenditure items

Description	Year ending 31	Year ending	Difference	percentage
	December 2023	31 December 2022	{ Favorable / (Unfavorable) }	
	Rs. Million	Rs. Million	Rs. Million	(%)
<u>Revenue</u>				
Construction Income	6,854.08	6,332.58	521.5	8
Other Income	78.39	154.89	(76.5)	(49)
Financial Income	701.36	320.92	380.44	119
<u>Expenses</u>				
Cost of Sales	6,383.50	5,695.76	687.74	12
Selling and distribution expenses	14.96	43.43	(28.47)	(65.5)
Financial expenses	15.36	7.98	7.38	92
Administrative expenses	917.31	806.68	110.63	14

Management should focus on strategically reducing cost of sales and administrative expenses, and planning to increase construction revenue, which is the main source of revenue.

2.3 Ratio Analysis

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

Ratios	2023	2022
Profitability Ratios		
Gross Profit Ratio (GP) (%)	6.87	10.05
Operating Profit Ratio (%)	-5.6	-0.92
Return on Assets (ROA) (%)	2.13	1.87
Liquidity Ratios		
Current Assets Ratio (Number of times)	1: 1.2	1:1.2
Quick Assets Ratio (Number of times)	1:1.1	1:1.1

In the year under review, the gross profit margin was 6.8 percent, which was decreased by 32 percent compared to the previous year. Further, the company had earned a pre-tax profit of Rs.302 million in the year under review using its total asset base of Rs.14,214 million. Hence, the average rate of return on total assets was only 2.13 percent. Management should attend to prepare and implement a strategic plan on how resources can be utilized to maximize operating profit while maintaining an optimal gross profit ratio in the coming period.

3 Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
Due to weaknesses in project management, a sum of Rs. 105.75 million had been deducted from the bills by the employers as liquidated damages related to 62 projects. Although it was able to recover such deducted amount of Rs.36.81 million for 09 projects, approvals were not received for the extension of time had been applied for 18 projects by 31 December 2023 and the deducted liquidated damages amounting to Rs. 49.01 million related to 35 projects was irrecoverable.	Time extensions have been approved for the projects which the late compensation money has been collected and work is being done with the employers to release the money and efforts are being made to get all available money.	That proper project monitoring and management should be undertaken to avoid liquidated damages.

3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Out of the 05 asphalt/crusher machines that were operating at 05 locations, and the company had incurred a loss of Rs.18.96 million in the year 2023 due to the operation of 02 machines and the other 03 machines were in idle condition.	As these machines are owned by CECB, their cost is contained in CECB's accounts. The primary reason for this loss is due to the maintenance costs incurred despite being idle. The crisis in the construction industry has also contributed to this loss.	The management of the company should focus on running the asphalt/crusher machines profitably.
(b) In the year 2019, the company had paid Rs.15.43 million as rent at once without entering into a formal agreement to acquire 60 perches of land in the Ratnapura district belonging to the Urban Development Authority on a 30-year lease basis and the Sabaragamuwa base office building was built on this land.	In order to complete this lease deed to the Urban Development Authority, the Urban Development Authority should obtain the exemption papers under Section 6 (1) of the Government Land Ordinance for the land parcels comprising of 348 acres including this land. It has been informed that after the completion of the above activities, it is possible to complete this rent deed. Also, the Sabaragamuwa base office and warehouse were operated in a building and land previously acquired on a rental basis, thereby avoiding a rental expense of Rs.3.8 million.	Since the company has paid the full rent, the relevant agreement should be signed with the Urban Development Authority as soon as possible.
(c) Although the Rambakanoya project was first undertaken by CECB and handed over to the company in the year under review, the handover process had not been properly completed by the end of the year, so the value of the assets including construction and development work carried out on the land had been included in CECB's financial statements.	This agricultural project was first undertaken by the Central Engineering Consultancy Bureau, and a cost of Rs.17.28 million has been incurred for this project. Accordingly, in the year 2024, I would like to mention that arrangements will be made to record this amount in CESL.	The project handing over process should be properly completed and recognized in the financial statements.

3.3 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Assets costing to Rs.1,558.05 million as at 31 December 2023 were not properly coded for enable to carry out the annual verification and those codes were not included in the existing fixed asset register in the ERP computer system.	These days the work of correcting the differences in fixed assets is being done, and the coding of fixed assets will be formalized as soon as it is completed.	Those assets should be coded properly.
(b) The Company has sustained the operating losses of Rs.942.90 million Rs.667.42 million and Rs.888.15 million from its fully completed construction projects in the years 2023, 2022 and 2021 respectively and in the year under review, company had incurred a loss of Rs.528.57 million from 40 ongoing construction projects. Although these losses directly affect to the going concern of the Company, the management had not taken effective measures to identify the persons and reasons directly or indirectly responsible for these losses and to reduce such heavy losses.	Project completion took longer than estimated due to material cost over estimated cost, high overhead cost, delay in obtaining EOT approvals, pandemic situation, payment delays etc.	Management should take effective measures to manage contract cost and time and prevent losses from construction projects.
(c) During the year under review, the Company had sustained an operating loss of Rs.383.30 million. As a result of earning an income of Rs.701.36 million from fixed deposits a profit before tax had been shown in the Financial Statements.	Due to the crisis situation in the construction sector, the operations have suffered losses.	Efforts should be made to turn operational losses from construction projects into profits.
(d) The losses of Rs.198.02 million, Rs.31.66 million, Rs.151.60 million and Rs.33.67 million had recorded by Central Base Office, Gampaha Base Office, Anuradhapura Base Office and Mechanical Division respectively. As a result the company had incurred an operating loss of Rs.383.30 million for the year under review.	Due to the downturn in the construction industry caused by the economic crisis and the Covid epidemic, we had to maintain the projects of several of our company's base offices at a loss level.	The management should focus on efficient use of financial, human and other physical resources for its construction activities to reduce operational loss in each division of the company.

3.4 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
(a) The balances of Rs.875.39 million and Rs.4,188.91 million were shown in the financial statements as due from customers and due to customers respectively as at 31 December 2023. However, there should be no such balance after the completion of a project by the Company and due to non-submission of bills in a proper and timely manner, a sum of Rs.69.24 million and Rs.15.58 million in respect of 16 completed projects had been shown as due from customers and due to customers respectively in the financial statements.	Settlement of these balances will take time due to delay in final billing certification. As the final invoices remain unconfirmed, the contract amount cannot be amended, so the settlement of these values takes time.	Actions should be taken to ensure final billing without delay.
(b) Although all Value Added Tax (VAT) payments are made on a cash basis by the head office of the company, the accrual concept had been used to account for those VAT payments. A difference of Rs.16.16 million was observed between the VAT payable and receivable shown in the document submitted by the base offices for the month of December 2023 and final financial statements. The company had not maintained a monthly reconciliation process to reconcile this discrepancy.	As CESL is registered to pay VAT on cash basis, VAT payments are made accordingly. For that purpose, ERP system prepares two reports related to separate inputs and outputs based on cash book. Accordingly, the correct amount of tax payable will be calculated according to the cash basis. This system ensures that the payments made to the Inland Revenue Department are done very accurately.	The system should be developed so that the input and output invoices that account for this change can be identified and reconciled on a monthly basis by the separate ERP system.

3.5 Human Resources Management

Audit Issue	Management Comment	Recommendation
The company had recruited 09 employees for the posts which are not in the approved cadre as on 31 December 2023. It was also observed during the audit that there was a difference between the number of CECB staff members had been engaged to CESL was 129 and the number of CESL staff engaged from CECB was 140 and the reasons for this difference had not explained to the audit.	Accept that the number attached is 118. It was only later that we were correctly informed that certain officials had been released from the CECB. The procedure for recruiting 09 employees for posts not included in the approved number of employees on December 31, 2023 and new posts have been referred to MSD for approval.	Arrangements should be made to get the cadre approval promptly, and recruitment should not be made for unapproved positions.