State Development and Construction Corporation

1. Financial Statements

1.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.2 of this report, the financial statements give a true and fair view of the financial position of the State Development and Construction Corporation as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Accounting Policies

The following observations are made.

a) **SLFRS 01- First Time Adoption of Sri Lanka accounting Standard,** The value of the Property, Plant and Equipment (PPE) were not stated at any comparable situation to the fair value due to the Corporation had disclosed in their accounting policy statement No 2.2.1 that they have used the carrying amount that have been reported under the previous General Accepted Accounting Principles (GAAP) as deemed cost for the items of PPE. According to the Paragraph 30 of the Standard, a first time adoption may elect to use a previous GAAP revaluation of an item of PPE at or before the date of the revaluation broadly comparable to the fair value or cost or depreciated cost. However, last revaluation of the above assets had been done in 2005 and no fair valuation had been done at the transition date of 31 December 2012.

b) **LKAS 11-Construction Contract -** Aaccording to the Paragraph 11 of the Standard, the amount of contract expenditure should be increased if any penalties arise from the delays caused by the contractor. The client had been imposed the delay charges amounting to Rs.64,787,412 to the Corporation (Contractor) in time to time. However, these delay charges had been taken as receivables instead being treated as expenditure without having substantial evidence for recovery. Out of the above mentioned amount, the delay charges amounting to Rs.32,631,357 was related to the projects that were not in operation and completed and handed over long before at the end of the year 2012. So that, it is not fair at all to show such amount as receivable. As a results, the current assets and profit shown in the financial statements as at 31 December 2012 had been overstated by Rs.64,787,412.

Further, the clients had claimed the liquidated damages of Rs.73,510,382 in respect of 20 Projects which delayed due to faults of the Corporation.

c) **LKAS 16 – Property, Plant and Equipment (PPE**)-Even though according to the Standard the PPE should be taken into accounts if the future economic benefits are embodied therein, the land and buildings disclosed under Note 9.1.5 to the financial statements valued at Rs.75,870,875 had been utilized by the Corporation since 2005 had not been taken into accounts due to non-availability of the ownership contrary to the provision in the Standard.

1.2.2 Accounting Deficiencies

The following observations are made.

(a) Expenditure such as repairing cost of plant and machinery, finance cost etc. aggregating Rs.35 million relating to the Segment of Construction Division had erroneously been classified under the category of other Segments. Therefore, the Segmental information had not been accurately disclosed in the financial statements. Further, the accuracy of the apportioned method used for appropriate the finance cost and related cost of PPE between the two Segments could not be ensured in audit.

(b) Uncertified bills valued at Rs.32 million in relation to the Project bearing Nos. 943 which were completed in 2012 had also been taken into account in ascertaining the income of the year under review and as a result, the revenue shown in the income statement had been overstated by similar amount.

(c) Provision had not been made in the financial statements for a sum of Rs.27,417,928 due from a Joint Venture Company which is not in operation at present.

(d) Amount payable to the Corporation by the Fujima State Corporation (Pvt) Ltd, a Joint Venture Company as per their financial statements for the year ended 31 March 2010 was Rs.41,899,490 and no transactions had been taken place thereafter. However, no such balance was appeared in the financial statements of the Corporation and as a result, the other receivables shown in the financial statements of the Corporation as at 31 December 2012 had been understated by that amount.

The Chairman of the Corporation states in this regards as follows.

Though there is a payable balance in the books of accounts of the Fujima State Corporation (Pvt) Ltd to the SD&CC, no such due balance is in our records.

(e) The differences of Rs.1,219,549 and Rs.3,310,363 relating to the cost of PPE and accumulated depreciation respectively had been identified between the amount shown in the general ledger and the corresponding balances shown in the fixed assets register and subsequently those differences had been adjusted in the general ledger accounts without being investigated. As a result, the accounting treatment made for the net difference of Rs.2,090,813 by crediting to the income for the year under review and debiting to the PPE was not accurate.

(f) According to the information furnished to audit, the default Bank Guarantees valued at Rs.48,488,000 relating to a Joint Venture of the Corporation had been paid to the Bank by the General Treasury on behalf of the Corporation and it had been erroneously classified as a liability and included in the financial statements.

(g) A sum of Rs.15 million payable to the Ministry of Economic Development in respect of granting the plant and machinery to the Corporation had not been brought to the accounts.

(h) The Pay As You Earn (PAYE) Tax amounting to Rs.6,957,317 paid by the Corporation on behalf of its employees for the period 2009 – 2012 had been treated as an expenditure of the Cooperation without being deducted from the salaries of the of the respective employees. Further, the provision for the penalties on the delayed payment of PAYE tax amounting to Rs.515,438 had not been made in the financial statements.

1.2.3 Unexplained Differences

According to the information made available value of Bitumen collected by the Corporation was Rs.47 million. However, the Goods Received Notes had been issued for Rs.51 million. The reason for the difference was not explained to audit.

1.2.4 Accounts Receivables and Payables

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The following observations are made.

(a) Debtor balances of the Construction and Concrete Yard Divisions of the Corporation amounting to Rs.43,317,948 and Rs.30,613,460 respectively had remained outstanding for more than three years as at 31 December 2012. Of them Rs.24,171,000 and Rs.18,061,042 respectively were remained outstanding for a period of more than 05 years without being taken any recovery action. Further, age analysis for sundry debtor balances of Rs.34,594,399 outstanding as at 31 December 2012 was not furnished to audit.

(b) Retention money receivable amounting to Rs.42,552,323 shown under receivable in the financial statements was remained outstanding for a period of more than five years as at 31 December 2012. Further, some of the Projects which the retention money receivable had been completed and handed over to the clients several years ago and certain other Projects had been terminated due to various reasons. Hence, it was observed that those balances had been carried forward in the financial statements year by year without any substantial evidence for recovery.

(c) Abnormal mobilization advance balances of Rs.15,211,080 was observed relating to seven Projects which was fully completed Projects as at 31 December 2012.

(d) Purchase advances for construction contract amounting to Rs.11,364,505, Rs.5,935,128 and Rs.21,394,225 had been remained outstanding for a period of more than 10 years, 5 to 10 years and 2 to 5 years respectively without taking any action. In addition, the age analysis for purchase advance of Rs.23,428,134 relating to the Peliyagoda office of the Corporation was not made available for audit.

1.2.5 Lack of Evidence for Audit

The following observations are made.

(a) A detail schedule for the National Security Levy payable amounting to Rs.885,971 as at 31 December 2012 was not made available for audit.

(b) A cash cheque for Rs.500,000 had been issued to an officer of a Joint Venture Company of the Corporation. This practice may lead to misuse the public fund. In the meantime, the details of the expenditure incurred from this money paid were not made available for audit.

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

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

	Reference to Laws, Rules, etc.	Non-compliance
(a)	Section 14(1) of the Finance Act, No. 38 of 1971	The Draft Annual Report for the year under review which should be submitted to the Auditor General together with the draft financial statements was not submitted.

(b)	Section 8.8 of the Public Enterprises Department Circular No PED/12 of 02 June 2003	Approval of the Board should be obtained for the delegation of financial authority, indicating limits of expenditure and no expenditure should be authorized, incurred or paid outside the limits of such delegated authority. Further, such delegation of authority should be updated and approved by the Board at the beginning of each year. However, the Corporation had not complied with those requirements.

2. Financial Review

2.1 Financial Results

According to the financial statements presented for audit, the operations of the Corporation for the year under review had resulted a pre-tax net profit of Rs.65,872,244 as compared with the corresponding pre-tax net profit of Rs.42,316,969 for the preceding year, thus indicating an improvement of Rs.23,555,275 in the financial results of the year under review. The increase of income of the Concrete Yards by Rs.422,666,999 was the main reason for this improvement.

2:2 Analytical Financial Review

The following observations are made.

(a) The gross profit margin of the year under review was 3 per cent, as compared with that of 11 per cent in the previous year which shows 3 per cent decrease. Actual gross profit margin of the year 2012 was far behind as compared with the target of 10 – 15 per cent.

(b) Interest cover ratio was around 2 times in both 2011 and 2012 which indicated the Corporation has managed their interest cost efficiently and effectively.

(c) Trade and other receivables of the year under review represented 43 per cent of the total assets and the ratio between the current assets and current liabilities of the year under review was 1:0.94. Hence, it was revealed that the Corporation had functioned with a poor working capital management in 2012.

3. Operating Review

3.1 Performance

The Corporation had handled 54 construction contracts to the value of Rs.12,459 million in 2012. Most of the projects had delayed in the range of 6 to 82 months due to various reasons such as liquidity problems of the Corporation, non-receipt of the payments from clients in time, bad weather condition, design changed by the clients and management inefficiency and a total loss of Rs.23,842,299 had occurred from the delayed Projects in 2012.

3.2 Management Inefficiencies

The Bitumen had been purchased on credit basis from the Ceylon Petroleum Corporation and the Ministry of Economic Development had settled the bills on behalf of the Corporation. The Corporation had confirmed that the Ministry was issued Good Received Notes (GRN) for Rs.537,810,476 of Bitumen in 2012. However, it was revealed that Bitumen had not been received by any sites of the Corporation, but directly handed over to the suppliers and sub-contractors of the Corporation, without being recorded in the stock ledgers maintained at sites. Further, those GRNs had been issued by a clerk in the Head Office on behalf of the store keepers attached to the respective sites and approved by the Deputy General Manager (Construction). Accordingly, the management had failed to introduce a proper system and control to minimize the irregularities which had occurred from the existing system.

3.3 Transactions of Contentious Nature

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The following observations are made.

(a) The Corporation had incurred an expenditure of Rs.1,394,247 relating to the Fujima State Corporation (Pvt) Ltd, one of the Joint Venture Company out of its own funds in 2012. The following observations are made in this regard.

(i) The Project Manager at Bopitiya site had been granted a sum of Rs.400,000 for fuel expenses to start the operation of Kotedeniyawa site. However, evidence to ensure the commencement of the operation of the site and incurring the money for the intended purposes were not made available for audit.

(ii) Sub-contract labourers had been paid a sum of Rs.953,022 even though any operation had not been commenced in Kotedeniyawa site.

(c) The Corporation had outsourced its labour requirements from Manpower Companies since 2010. However, the Corporation had not obtained confirmation from the Employees Provident Fund (EPF) and Employees Trust Fund (ETF) whether the money collected by this companies from the Corporation as EPF and ETF contributions on behalf of these employees were actually being sent to those funds regularly.

(d) A generator of the Corporation valued at Rs.4,000,000 had been repaired externally despite the fact that the Corporation had a workshop having well experienced mechanicsl and technicians. It was further observed that a period of 21 months had been taken for the repair during which the Corporation had to hire two generators by incurring an additional cost of Rs.2,125,500 as rental.

(e) A sum of Rs.13,668,395 of incentive had been paid to selected personnel of the Construction Division of the Corporation in 2012 without having any approved incentive scheme.

3.4 Assets Management

Even though the Corporation had owned two asphalt plants located at Amithirigala and Polonnaruwa having a production capacity of 200,000 metric tons and the total production of the operational period of the year 2012 was only 14,210 metric tons which represented 7 per cent of the production capacity of that period. Without using the available capacity, the Corporation had purchased Rs.313,381,458 worth of asphalt from outside nine suppliers and the cost difference observed between the in-house production and purchases was Rs.79,517,458.

3.5 Identified Losses

The following observations are made.

(a) Penalty imposed due to non-remittance of the EPF and ETF on due dates for the period from February to December 2012 was Rs.18,291,274.

(b) Interest paid for the non- payment of the employees gratuity on due dates in 2012 was Rs.381,155.

(c) Concrete products had not been supplied on time and therefore, delay chargers of Rs.6,003,112 had to be paid by the Corporation.

3.6 Resources Given to Other Institutions

Four employees had been released to the line Ministry without the approval of the Cabinet of Ministers as specified in the Public Enterprises Department Circular No. PED/12 of 2 June 2003 and the cost incurred by the Corporation for those employees in 2012 was Rs.1,449,297.

4. Accountability and Good Governance

4.1 Corporate Plan

The following observations are made with regard to the Corporate Plan for the period 2012 – 2014.

a) Specific objectives and strategies for the individual seven Sub-divisions operating under the Corporation had not been identified. Hence, achieving of the entire objectives specified in the Corporate Plan is questionable.

b) According to the following information, the targets set out in the Corporate Plan were either unrealistic or not taking proper follow-up actions to achieve them.

Item	**Target as per Corporate Plan**	**Actual**
	Rs. million	**Rs. million**
Turnover growth	Not mentioned	
Pre-cast concrete products	650	423
Consultancy fee	30	2.7
Overseas construction	50	-
Profit before tax	241	66
Net profit margin (%)	6	2

(c) The Action Plan and the Budget for the year under review had not been in line with the Corporate Plan.

(d) The following strategies highlighted in the Corporate Plan had not been implemented even in the year under review.

- Implementing of cost control and accounting system to set out competitive prices for concrete products
- Disposal of non-moving concrete items
- Carrying out sales promotion and advertising programmes for concrete products
- Implement a proper cash disbursement system for internal sales in order to minimize the delay in supplying external orders due to cash flow problem.

4.2 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. 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 by my detailed report issued in terms of Section 13(7)(a) of the Finance Act. Special attention is needed in respect of the following areas of control.

(a) Accounting
(b) Trade and Other Receivables
(c) Trade and Other Payables
(d) Performance Review
(e) Human Resource Management
(f) Statutory Payments
(g) Assets Management
(h) Project Administration and Sub-contracting
(i) Utilization of Resources
(j) Financial Management