

Lakdiva Engineering Company (Pvt) Limited – 2017

The audit of financial statements of the Lakdiva Engineering Company (Pvt) Ltd 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 notes to the financial statements and a summary of significant accounting policies 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. My observations relating to the performance of the Company for the year under review which I consider should be tabled in Parliament in terms of Article 154(6) of the Democratic Socialist Republic of Sri Lanka, appear in this report.

1.2 Responsibility of the Board of Management for the Financial Statements

The Board of 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 Auditor's 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. 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 judgement, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company'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 Company'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 financial statements.

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 Disclaimer of Opinion

- (a) Due to non-availability of a Register of Fixed Assets or detailed schedules relating to the Property, Plant and Equipment worth Rs. 8,290,423 shown in the statement of financial position as at 31 December 2017, I could not verify the assessment, accuracy, and completeness of those assets. Furthermore, the useful

life, the depreciation policy used, or percentage of depreciation had not been disclosed in the accounts in terms of Sri Lanka Accounting Standard, 16.

- (b.) The Company had not conducted physical verification on goods as at 31 December 2017. I could not verify the assessment, accuracy, and completeness of the goods worth Rs. 17,565,649 shown in the statement of financial position as at 31 December 2017.
- (c.) This Company had not registered for Income Tax, Value Added Tax, and Nation Building Tax.

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the significance of the matters described in Paragraph 1.4 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 Requirements

I express the following matters in accordance with Section 163 (2) of the Companies Act, No. 07 of 2007.

- (a.) Basis for audit opinion, scope of audit, and limitations are as mentioned above.
- (b.) I have not been able to obtain all information and explanations as mentioned above, and hence, I do not express an opinion on those financial statements.

2.2 Non-compliances with Laws, Rules, Regulations, and Management Decisions

The following instances of non-compliances with Laws, Rules, Regulations and Management Decisions, were observed.

Reference to Laws, Rules, and Non-compliance Regulations, etc.	Non-compliance
---	-----------------------

- | | |
|--|--|
| - | |
| a) National Environmental Act, No.47 of 1980 as amended by Acts, No. 56 of 1988 and No.53 of 2000;
Section 23 (a) | A license should be obtained by the institutions involved in servicing vehicles. However, such a license had not been obtained by the Company even up to 20 March 2019, the date of audit. |
| b) Section 60 of the Inland Revenue Act, No.24 of 2017. | A company is liable for paying taxes, but the Company had not taken measures even up to 21 March 2019 - the date of audit, to fulfil that requirement. |

- c) Factories Ordinance, No. 33 of 2000.
- (i.) Section 12 (1) Effective and suitable provision shall be made for securing and maintaining by the circulation of fresh air in each workroom the adequate ventilation of the room, and for rendering harmless, so far as practicable, all fumes, dust and other impurities injurious to health that may be generated in the course of any process or work carried on in the factory. Nevertheless, it had not been so done.
 - (ii.) Section 13 (1) Effective provision had not been made for securing and maintaining sufficient and suitable lighting, whether natural or artificial, in every part of the factory
 - (iii.) Section 39 (1) Means of escape in case of fire for the persons employed as may reasonably be required should be provided. But, it had not been so done.
 - (iv.) Section 42 (a) (1) Fire extinguishers should be supplied for any factory in accordance with the directives in that connection. But, the Company had not followed any of those steps.
 - (v.) Section 50 (1) There should have been provided and maintained so as to be readily accessible a first-aid box or cupboard of such standard as may be prescribed. However, the Company had not paid attention thereon.
 - (vi.) Section 53 (1) There should have been provided suitable eye protection for the employees of the factory. However, no measures had been taken in that connection.
- d) Section 5.3 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003. A Corporate Plan had been prepared for the period 2016-2019 in order to achieve the vision and mission of the Company, but approval of the Board of

Directors had not been obtained thereon even by January 2019.

e) Treasury Circular, No. 842, dated 18 December 1978. A Register of Fixed Assets had not been maintained in terms of the Circular.

f) Procurement Guidelines - 2006

(i.) Guideline 3.4.2 (a)

Requests for quotations should be addressed to individuals / firms. However, as for the purchase of sheets, metal, paints and spare parts valued at Rs. 29,272,266 relating to the repairs on the chassis of the busses, the Company had not made such requests.

(ii.) Guideline 3.4.3

Suppliers had not been registered for procurement of items of small value or for purchases of items used frequently, for which advertising may be uneconomical.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Company for the year under review was a surplus of Rs. 14,677,560 as compared with the corresponding surplus of Rs. 5,085,866 for the preceding year, thus indicating an improvement of Rs. 9,591,694. The increase in the income from the repairs on busses amounting to Rs. 9,591,694 in the year under review had mainly attributed to the said improvement.

4. Operating Review

4.1 Performance

According to the Action Plan for the year 2017, it had been planned to repair 88 busses under the categories of full repairs, semi repairs, and accident repairs, but only 68 busses had been repaired during the year under review. The following observations are made in this connection.

(i.) Ten instances were observed in which delays ranging from 10 to 69 days had occurred to commence repairs after the busses being handed over to the repair groups for repairing the chassis.

(ii.) As for the computation of labor costs, four employees in a contract labor group are taken into consideration. Eight instances were observed during the physical inspection in which less than 4 laborers had been employed.

4.2 Management Activities

The following observations are made.

- (a.) The Company owned an engineering division for repairing the chassis of the busses – the main function of the Company. An estimate for the items such as, metal, sheets, nails, paint, and cushion, required for repairing a bus, is not prepared in order to obtain such materials; instead, such items are obtained from the stores at the time of making repairs. Due to failure in purchasing spare parts in accordance with an estimate, purchases are made irregularly, thus observing in audit that the Company incurs an additional cost.
- (b.) According to the existing methodology, invoices are prepared by adding 20 per cent of the profit. However, the approximate gross profit ratio of the Company for the years 2016 and 2017 was observed to have been 12 per cent and 15 per cent respectively.
- (c.) As for the identification of revenue from busses, it was observed that invoices were not prepared on a logical basis. According to the invoices, the sales cost of the busses in the year 2017 amounted to Rs. 71,340,156, but the sum of Rs. 77,400,082 was shown in the revenue statement of the year as sales cost, thus observing a difference of Rs. 6,059,927. In preparing the invoices, the overhead cost had been considered as 30 per cent of the labor cost. The basis for that percentage was not verified in the audit.
- (d.) Works in progress had been calculated based only on material cost and labor cost. It was observed that works in progress should be calculated by considering the overhead cost as well. As the works in progress had been considered less, the profit was observed to have been understated.

4.3 Operating Inefficiencies

The following observations are made.

- (i.) Sixteen CCTV cameras and accessories valued at Rs. 524,900 had been purchased on 07 April 2016, but those cameras remained non-functional from the time of purchase, and only one camera was seen at the premises of the Company as at the date of audit, 13 March 2019. The Company was observed not to have taken any action in that regard. As no agreement was entered into with the relevant company, the loss sustained by the Company could not be recovered as well.
- (ii.) The Company was maintained at a land in extent of 23 acres located in Ekala. Of the 20 rolls of barbed wire purchased in the year 2017 at a value of Rs. 124,000 for erecting the fence around the yard of Division 1, only 06 rolls had been used.
- (iii.) Tools and instruments had been issued from the stores to the external contractors involved in repairing busses. Such items should be returned to the stores daily, but it was observed that a methodology for returning the tools was not in place. It was

also observed that the said tools and instruments were returned to the stores only when they were broken.

- (iv.) It was observed in audit that the Company had not made any purchase in accordance with a Procurement Plan. Furthermore, spare parts and materials required for repairing the chassis of the busses had been purchased without ensuring economic benefits. In some of such instances, purchases were made once the stock of materials and spare parts had become unavailable in the stores.

4.4 Idle and Underutilized Assets

The motor coach bearing No. 23 3872 , and the Great Wall bus bearing No. 61/9401 could not be run due to not being licensed. As the ownership of those vehicles had not belonged to the Company, licenses could not be obtained, but the Company had not taken measures in that connection. The said 2 busses had remained decaying at the premises of the Company for a period of 2 years.

4.4 Staff Administration

The following observations are made.

- (a.) The approved cadre of the Company stood at 121 as at 31 December 2017. Of that, 60 employees had been recruited on permanent basis, whilst 30 and 12 employees had been recruited on casual and contract bases respectively. Thirty six posts remained vacant whereas 17 recruitments had been made in excess. No recruitments had been made since the inception of the Company to the post of General Manager, the main post relating to the management of the Company. A recruitment had been made on contract basis to one of the 2 approved posts of Factory Engineer which was relevant to the performance whilst the other post remained vacant since the inception.
- (b.) Approval had been given for the new cadre structure of the Company through the Letter, No. DMS/1623 of the Department of Management Services, dated 03 October 2018. Although recruitments should have been made in accordance with the Scheme of Recruitment, action had not been taken to prepare and approve the Scheme of Recruitment even up to 13 March 2019, the date of audit.
- (c.) The post of Administrative Officer of the Company remained vacant. As per the Decision, No. 2013/49/01 of the Board of Management, a Management Assistant had been appointed to that post on acting basis for a period of 6 months with effect from 01 November 2013. However, even after the period of 6 months, she continued working in that post, and was appointed again for a period of 03 months with effect from 01 May 2015 through the Letter, No. LEC/CHR/01/15 of the Chairman, dated 30 April 2015 subject to the covering approval of the Board of Directors. Nevertheless, approval of the Board of Directors had not been obtained in that connection, and the Commission had not taken measures to recruit an officer during that period. Furthermore, it was observed that the

said officer was discharging functions in the post of Administrative Officer from 01 May 2015 up to 03 June, the date of audit. As such, she had discharged functions in the post of Administrative Officer over a period of 4 years without obtaining approval of the Board of Directors. A sum of Rs. 132,240 had been paid as acting allowance for the period 2017-2018 alone.

- (d.) In order to discharge functions of the post of Account Officer of the Company, a Management Assistant had been appointed to that post for a period of 3 months subject to the covering approval of the Board of Directors in accordance with the Letter, No. LEC/CHR/01/15, of the Chairman, dated 06 March 2015. However, approval of the Board of Directors had not been obtained thereon. The said officer continued discharging functions of the vacant post, and he had been appointed again to the said post by the Chairman with effect from 01 November 2018 until the vacancy was filled. Approval of the Board of Directors had not been obtained in that connection, and it was observed that an officer had not been recruited permanently to that post even up to 03 May 2019, the date of audit.

5. Accountability and Good Governance

5.1 Establishment and Ownership of the Company

Lakdiva Engineering Company (Pvt) Ltd had been established on 01 October 2001 as an entity owned by the Government, and was registered on 15 August 2011 under the Companies Act, No. 07 of 2007. The authorized capital of the Company comprised 650,000 average shares each valued at Rs. 10, and only 2 shares therefrom had been issued. The said 2 shares had been purchased by the Secretary to the Treasury and the Secretary to the Ministry of Transport.

5.2 Presentation of Financial Statements

In terms of Section 6.5.1 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003, the financial statements and the draft annual report for the year under review should be presented to the Audit within 60 days from the closure of the year of accounts. However, the financial statements of the year 2017 had been presented on 27 May 2019 after a delay of 02 years and 05 months.

5.3 Corporate Plan

A Corporate Plan should have been prepared for a period not less than 3 years in order to fulfill the vision and mission of the Company in terms of Section 5 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003. However, the Company had not prepared a Corporate Plan.

5.4 Internal Audit

An Internal Audit Unit had not been established for the Company.

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 Company from time to time. Special attention is needed in respect of the following areas of control.

Systems and Controls

Observation

- | | | |
|------|--------------------------|--|
| (a.) | Control of Fixed Assets. | Failure to maintain a Register of Fixed Assets and physically verify the fixed assets. |
| (b.) | Stocks Control. | Failure to conduct stock surveys and take action on the unusable stocks. |
| (c.) | Procurement Activities. | Failure to prepare a Procurement Plan, and making purchases without following procurement methodologies. |
| (d.) | Staff Administration. | Failure to take action to make recruitments for the vacant posts. |
| (e.) | Control of Vehicles. | Failure to maintain daily running charts and check the fuel consumption in a timely manner. |