State Engineering Corporation of Sri Lanka - 2017

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1. Financial Statements

1.1 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 2017 and 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 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, mobilization advance received accounts, sub-contractor's accounts, sub-contractor's retention accounts, accrued and provision accounts had been offset against the credit balances of those accounts. Hence, the credit balances of such as accounts had been understated by Rs.25,542,855, Rs.240,525,285, Rs.44,696,625, Rs.259,612,535 and Rs.159,454,338 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 range of 90 to 95 per cent of finished goods as at 31 December 2017 had been valued at per cent of the net realizable value. As such the accuracy of the finish goods value Rs.245,149,766 shown in the financial statements could not be relied upon in audit.

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

The following observations are made.

(i) Fixed assets and software amounting to Rs.91,671,319 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.

(ii) The recurrent expenditure of plant and machinery repairs amounting to Rs.5,612,605 had been capitalized without being charge to the income statement. As a result the fixed assets and profit of the year under review had been over stated.

(iii) The Motor vehicles repairs charges amounting to Rs.3,851,120 had been capitalized without being charge to the income statement. As a results the fixed assets and profit of the year under review had been over stated.

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

The following observations are made

(i) No provisions had been made in the Financial Statements in respect of fines totaling to Rs.121,782,475 , Rs.2,598,573 and Rs.162,788 imposed by the Department of Inland Revenue on unpaid Value Added Tax for the year 2013 to 2016, Economic Service Charge and NBT for the year 2016 respectively.

(ii) The Diesel Engineering Motor Company (DEMO) had filed a legal case against the Corporation by claiming Rs.97,000,000 with regard to supply of lift to vehicle park 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, fourteen legal cases claiming amounting to Rs.83,715,034 against the Corporation by the sub-contractors and suppliers had not been disclosed as contingent liability in the financial statements for year under review.

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

The following observations are made.

(i) Although the loan and receivables should be measured at amortized cost method, trade receivable balance over 5 years amounting to Rs.168,618,915 had not been measured at amortized cost method. Hence, there is a possibility to overstate those balances in the financial statements.

(ii) The retention receivable balance of Rs.563,887,942 remained over 5 years had not been considered for the impairment. As a result it had not been reflected in the financial statement at fair value.

1.2.2 Accounting Deficiencies

The following accounting deficiencies were observed.

(a) Since there were unusual credit balances of Rs.71,646,891 , Rs.100,954,543 and Rs.259,612,534 in the ledger account of trade debtors, cheque with order advance, and retention receivable balance respectively as at the end of the year under review, those values as at that date had been understated by similar amounts.

(b) The retention receivable balance was overstated by Rs.5,323,646 due to erroneously debited the VAT recovery of retention to the retention receivable account in the year under review.

(c) 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 in respect of the project which were commencing prior to the year 2017. Hence, the completion percentage of those project had not been correctly calculated and therefore the profit for the year and accumulated profit had been overstated and understated respectively.

(d) The Economic Service Charge amounting to Rs.3,456,829 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 that amount.

(e) The Nation Building Tax (NBT) payable amounting to Rs.5,279,315 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 that amount.

(f) The revenue of the year under review had increased by Rs.17,136,086 because of incorrect recognition of revenue project of National Equipment and Machinery organization(NEMO) .

(g) The land valued at Rs.7.2 million owned to the Seruwawila Rajamaha Viharaya had been erroneously 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 that amount.

(h) Even though the land and building valued at Rs.111.92 million shown in the Financial Statements were not belongs to the NEMO, accumulated depreciation of the building amounting to Rs.4,120,908 and depreciation of Rs.889,908 for the year had been shown in the Financial Statements for the year under review.

(i) The concrete slippers costing to Rs.9,304,950 rejected by the Department of Railway had been remained in the stocks for over 05 years. Only an impairment of 25 per cent or amounting to Rs.2,326,239 only and been made thereon during the year under review. As results, the value of stocks had been overstated in the Financial Statements for the year under review.

(j) The stock provision had been under stated by Rs.2,304,544 and profit had over stated due to calculation error of stocks provision.

(k) The stock value at Rathmalana site was (343) understated by Rs.1,114,000 due to error in valuation.

(l) The impairment had not been provided for debtor balances of Rs.31,354,164 and Rs.3,346,962 remaining over 3 years without being settling at service division and special operation division respectively.

(m) According to the fixed assets verification report the vehicle valuing to Rs.4.26 million had not been included in the fixed assets register. As a result the fixed assets value shown in the financial statement had been under stated by same amount.

(n) The inventories value had been overstated by Rs.1,260,672 due to calculation of cost erroneously.

(o) The unsalable inventories value amounting to Rs.2,417,870 were remained in stores without been impaired.

(p) The cost of sale value had been understated by Rs.23,759,731 as a results of offsetting abnormal minus balances .

1.2.3 Unexplained Differences

The following observations were made.

(a) A difference of Rs.64,468,337 was observed between the Inter group balance shown in the Financial Statements of the Corporation and NEMO.

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

(c) An unidentified deposit balance of Rs.1,328,763 relating to the period from 2012 to 2015 had remained in the Financial Statements of NEMO .

(d) A difference of Rs.2,624,108 was observed between receivable balance of the Corporation and payable balance shown in the financial statements of the Urban Development Authority.

(e) The difference of Rs.6,057,203 was observed between interest cost of loan and overdraft shown in financial statements and schedule of interest on loan and overdraft of the Corporation for the year under review.

1.2.4 Lack of Evidence for Audit

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

	Item of Account	Value	Evidence not made available
		Rs.	
(a)	GST Payable	9,594,208	Detail Schedules
(b)	Due to Customer balance	543,921,906	Detail Schedules
(c)	Accumulated depreciation of fixed assets NEMO	118,245,087	Detail Schedules
(d)	Revenue of NEMO	1,176,639,027	Project details in profit calculation of NEMO

1.3 Accounts Receivable and Payables

The following observations were made.

(a) Out of total trade debtors amounting to Rs.3,176,933,801, more than 95 per cent representing the amounts receivable from the Government Institutions and from that, a sum of Rs.1,248,600,741 or 43 per cent had remained unrecovered for more than 03 years.

(b) The pre-payment balance of Rs.1,426,440 had remained over 05 years at service division without being settled.

(c) The net retention balance of Rs.303,315,870 and Rs.563,887,942 had remained for over 03 and 05 years without being recovered.

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

(e) Out of the creditor balances amounting to Rs.540,234,948 a sum of Rs.14,257,406 had remained over 05 years.

(f) The VAT and GST payable balances totaling to Rs.887,178,455 were remained since year 2012 without being settled.

(g) The mobilization advances given to sub-contractors amounted to Rs.114,317,463 had remained over 05 years without being recovered.

(h) The advances given for services amounted to Rs.8,604,796 had remained over 05 years without being recovered.

(i) Deposits amounted to Rs.2,010,000 had remained over 05 years according to the age analysis.

(j) The advances of the suppliers totaling Rs.2,239,501 had remained over 05 years without being settled.

(k) The mobilization advance totaling Rs.442,666,325 received from the clients had remained over 5 years and action had not been taken to settled those balances as at 31 December 2017 .

(l) Out of the accrued expenses of Rs.784,804,346 an amount of Rs.583,144,664 had remained over 05 years without being recovered

(m) The Income tax balances totaling to Rs.10,562,151 had remained without being remitted to the Inland Revenue Department.

(n) The due from customer balance of Rs.197,876,933 and due to customer balance of Rs.32,040,246 were remained from the year 2015 without being settled.

1.4 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.14of 2002	Actions had not been taken to remit the Value Added Tax totaling to Rs. 48,735,735 for the year under review and Rs.78,914,988 relating to the year 2016.
(b)	Nation Building Tax Act No. 09 of 2009	Actions had not been taken to remit the Nation Building Tax totaling to Rs.1,193,334 for the year under review and Rs.1,196,626 relating to the year 2016.
(c)	Section 2(c) of the Circular, No. 121/1979 of 20 December 1979 issued by then Chairman of the Corporation.	Once the advances are given by cheques together with orders, such advances should be settled within a period of 30 days. However, such advances totaling to Rs.46,641,962 had remained unsettled over 3 years at Corporation . Further cheques with order advances totaling Rs,8,107,864 had remained unsettled from 2015 to the year under review at (NEMO).
(d)	Section 4 of the Circular, No. 122/1979 of 20 December 1979 issued by then Chairman of the Corporation.	Once the cash advances are given for supply of service or goods, such advances should be settled within a period of 14 days. However, special cash advance

balances given over 3 years amounting to Rs.1,935,050 and Rs.4,881,300 had remained unsettled at corporation and National Equipment and Machinery Organization as at 31 December 2017 respectively.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the operations of the Corporation during the year review had resulted in a post-tax net loss of Rs.612,714,083 as compared with the corresponding post-tax net loss of Rs.904,479,014 for the preceding year, thus indicating a decrease of net loss by Rs.291,764,931 in the financial results for the year under review. Increase of revenue by Rs.942,964,376 and deferred tax effect of current tax by Rs.569,787,951 were the main reasons attributed for this situation.

2.1.1 Value Addition of the Corporation

The detail of value addition of the Corporation from 2013 to 2017 was as follows.

	2017 Rs	2016 Rs.	2015 Rs.	2014 Rs.	2013 Rs.
Profit after Tax	(612,714,083)	(904,479,014)	(744,581,777)	74,534,988	122,726,033
(+) Employee Benefit	286,312,135	227,564,599	188,769,676	165,177,185	175,236,245
Tax Paid - VAT	121,520,561	78,839,708	79,009,022	154,211,263	223,179,026
ESC		-	-	-	-
- NBT	5,276,315	7,479,913	5,255,365	6,870,861	7,904,555
Depreciation	263,477,721	252,023,956	253,333,230	250,696,182	131,318,279
Value addition of the Corporation	(63,872,649)	(338,570,838)	(218,214,484)	651,490,479	660,364,138

The value addition of the Corporation had been deteriorated from the year 2013 and 2014 and after that it had shown abnormal negative results up to the year under review.

2.2 Analytical Financial Review

2.2.1 Profitability

An analysis on the financial results of the year under review and four preceding years revealed that there was a surplus in the year 2013,but it had gradually deteriorated since the year 2013 to the year under review. As such, the surplus of the year 2013 amounting to Rs.122,726,033 had become a deficit of Rs.612,714,083 by the end of the year under review. Details are shown below.

	2017	2016	2015	2014	2013
Revenue	3623,607,372	2,680,642,996	3,168,016,408	7,403,418,660	7,965,731,512
Gross Profit	839,853,709	(747,945,689)	(799,394,028)	195,346,353	522,549,676
(-) Administrative Expenses	(454,152,555)	(423,964,951)	(273,654,573)	(388,165,985)	(424,107,378)
Operational Profit/Loss	(1,294,006,264)	(1,171,910,640)	(1,073,048,601)	(192,819,632)	98,442,298
(+) Other Income	174,921,742	244,566,731	426,437,075	299,423,834	121,717,774
(-) Net Finance (Expense)	(197,457,199)	(112,768,542)	(62,224,359)	(59,998,458)	(71,587,241)
Profit / Loss before Tax	(1,316,541,721)	(1,040,112,451)	(708,835,885)	46,605,744	148,572,831
(-)Taxes	703,827,698	135,633,437	(35,745,892)	27,929,244	(25,846,798)
Profit/Loss after Tax	(612,714,083)	(904,479,014)	(744,581,777)	74,534,988	122,726,033

2.2.2 Accounting Ratios

Some of the significant accounting ratios for the year under review based on the information presented to audit are as follows.

Accounting Ratio	2016	2017
	Percentage	Percentage
Gross Profit Ratio	(28)	(23)
Net Profit Ratio	(33.7)	(17)
Administrative Expenditure on turn over	15.81	12.5
Net Financial Expenditure on turn over	4.20	5.4
Current Ratio	0.94	0.81
Quick Ratio	0.88	0.76

3. Operating Review

3.1 Identified losses

(a) It was observed that a loss of Rs.483,138 had been identified from a project which had not been operated during the year under review.

(b) It was observed that a total loss amounting to Rs.14,989,641 was incurred from four projects during the year under review which was operated by NEMO.

3.2 Matters of contentious Nature

(a) Out of the total accrued balance of Rs,784,804,346 , a sum of Rs.42,324,415 of debit balances and a sum of Rs.578,351,607 of credit balances shown under account code 8303 had remained without being identified the vender.

(b) Although debtor balances totaling to Rs.4,779,030 had been identified as impaired in the year 2016,those debtors had not been identify for impairment during the year under review and reason had not been furnished.

(c) The 62 projects value totaling to Rs.1,176,639,027 had been removed from the profit calculation of the NEMO for the year ended 31 December 2017. Reasons had not been furnished to the audit.

3.3 Working capital management

(a) The Corporation had obtained the bank overdraft of Rs.49,013,876 exceeding the approved facility as at 31 December 2017.

(b) The bank overdraft facility had been increased by Rs.82.9 million or 12 per cent when compared with the previous year as at 31 December 2017.