Maga Neguma Road Construction Equipment Company (Pvt) Limited - 2018

1.1 Disclaimer Opinion

The audit of the financial statements of the Maga Neguma Road Construction Equipment Company (Pvt) Limited for the year ended 31 December2018 comprising the statement of financial position as at 31 December 2018 and the statement of comprehensive income statement of changes in equity cash flow statement for the year then ended, and notes to the financial statements, including 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 read in conjunction with provisions of the National Audit Act No. 19 of 2018 and My comments and observations which I consider should be report to Parliament appear in this report.

I do not express an opinion on the accompanying financial statements of the Company. Because of the significance of the matters discussed in the Basis for Disclaimer of Opinion section of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.2 Basis for Qualified Opinion

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

As described in paragraph 1.5, I was unable to confirm or verify by alternative means, material items included in the statement of financial position, statement of comprehensive income, statement of changes in equity and cash flows.

As a result of these matters, I was unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded amounts and the elements making up the statement of financial position, statement of comprehensive income, statement of changes in equity and cash flows.

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 Auditor's Responsibility for the Audit of the Financial Statements

My responsibility is to conduct an audit of the Company's financial statements in accordance with Sri Lanka Auditing Standards and to issue an auditor's report. However because of the matters described in the basis for Disclaimer of Opinion section, I was not able to obtain sufficient appropriate audit evidences to provide a basis for an audit opinion on these financial statements.

1.5 Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

	Non-Compliance with the reference to particular standard	Management Comment	Recommendation
(a)	According to subsection 33.9 of section 33 of the LKAS for SMEs – Related Party Disclosures, if there were transactions between related parties; an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. However, the Company had not disclosed the nature of the related party relationship and related party transaction in the financial statements.	Accepted.	Company should disclosed the nature of the related party relationship and related party transaction in the financial statements According to subsection 33.9 of section 33 of the LKAS for SMEs – Related Party Disclosures
(b)	According to section 11 and 12 of the Sri Lanka Financial Reporting Standard for SMEs, an entity should chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. However, a provision had been made for doubtful debt amounting to Rs.230 million and actions had not taken to re-assess the impairment provision periodically in preparing financial statements.	Not Accepted. The value of the provision will be re assessed when preparing the next set of financials.	Actions should take to re-assess the impairment provision periodically in preparing financial statements According to section 11 and 12 of the Sri Lanka Financial Reporting standard for SMEs.

1.5.2 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(a)	As per the Information submitted by the project division of the Company, interim payment certificates (IPCs) on works completed during the year under review and certified by the Road Development Authority (RDA) amounting to Rs. 683.04 million had not been brought to accounts. As a result, income and current assets of the year under review had been understated by similar amount.	Not accepted. Revenue recognition criteria specify that revenue should be recognized in the financial statements at the point in which significant risk and rewards are transferred to the customer. In the context of construction works, point at which client approves the work done is the point significant risk and rewards attached to the works transferred to the client. Therefore, no deviation with the relevant accounting standards.	Action should take to record income which being occurred in the same year to make preventing to understate or overstate.
(b)	According to the information submitted by the Project Division of the Company, the interim payment certificates aggregating to Rs. 1,571.63 million in respect of works completed in the years 2012,2014,2015,2016 and 2017 had been accounted as income of the year under review. As a result, income and current asset of the year under review had been overstated by similar amount.	Not accepted. The Company recognizes revenue from construction works on the date in which certified bills received to the company.	Action should take to record income which being occurred in the same year to make preventing to understate or overstate.
	Since unavailability of interim payment certificates the Company had accounted income amounting to Rs.10.98 million received from projects, based on cash receipts acknowledgments without considering the interim payment certificates certified by the RDA.	Accepted. The problem is completely beyond the management's control. In some occasions, RDA sends the settlement before sending the certified bills.	Transactions should record based only on the most suitable and appropriate evidence.

(c)	Certified income in respect of year 2016 and 2017 amounting to Rs. 12.40 million had been recognized as current year income without adjusting to the opening retaining earnings. As a result, certified income of the year under review had been overstated by similar amount.	Accepted.	Action should take to record income which being occurred in the same year to make preventing to understate or overstate.
(d)	Since lease creditors as at 31 December 2018 had been erroneously classified in the financial statements for the year under review, the current liabilities were overstated and non-current liabilities were understated by Rs.8.29 million.	Accepted. Classification error in the face of Statement of Financial Position will be rectified in next financial statement.	All the liabilities of the company should classify after being identified correctly as current and non-current.
(e)	Advances in respect of projects those were closed or finalized, amounting to Rs.55.14 million are still being shown as advances in the financial statements of the Company, without being adjusted in the accounts.	Accepted.	All the advances should settle when the respective projects are closed or completed its construction works engaged.
(f)	The company had paid a sum of Rs. 9.28 million as insurance premium for the year 2018 and 2019. However, the insurance premium paid for the year 2018 amounting to 4.12 million had been shown as receivable, instead of being treated as expenses of the year under review. As a result, the insurance premium expenses had been understated and prepayments had been overstated by similar amount.	Accepted. Error will be rectified in the next financial statements.	All the payments relating to expenditure made by the company should record on accrual basis of accounting to reflect the real financial position of the company.

1.6 Un reconciled Control Accounts or Records

Item	as per Financial Statements (Rs. Million)	As per corresponding Record (Rs. Million)	Difference (Rs. Million)	Management Comment	Recommendation
Receivable on certified works and retentions from RDA	3,273.05	2,990.74	282.31	Accepted. There is reconciliation prepared as at the reporting date which indicates the reasons for the balance differences and rectification of errors still in progress.	Reconciliation should carry out periodically and measures should implement accordingly.
Difference of payable to the RDA from the company	1,541.29	378.58	1,162.72	Accepted.	Reconciliation should carry out periodically and measures should implement accordingly.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(i) Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 and the Extraordinary Gazette No. 1074/7 dated 07 April 1999 of the Democratic Socialist Republic of Sri Lanka.	Out of five (05) conditions stated in the Gazette, the company had been has satisfied four (04) conditions. However, the financial statements of the company had been prepared as per the Sri Lanka Accounting Standard for Small and Medium-Sized-Entities (SLFRS for SMEs) instead of being following Sri Lanka Accounting Standards (LKAS).	Not Accepted. The observation was highlighted during the audit for the year 2017 as well. According to the extraordinary gazette No. 1074/7 specify that any company which satisfy the given criteria must follow the Sri Lanka Accounting Standards when preparing the financials. However, among the available three set of accounting standards issued by the Institute of Chartered Accountants of Sri Lanka, the	The company should comply with Sri Lanka accounting standards since four conditions are fulfilled out of five (05) conditions stated in the Gazette No 1074/7 dated 07 April 1999 of the Democratic Socialist Republic of Sri Lanka.

		company is eligible to apply SLFRS for SMEs. No deviation with the regulatory requirements.	
(ii)The section 8.3.9 of the Public Enterprises Circular No PED 12 dated 02 June 2003.	Contrary to the direction given in section 8.3.9 of the circular, two vehicles belongs to the company had been released to Line Ministry.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(iii)Section 9.2 of the Public Enterprises Circular No PED 12 dated 02 June 2003.	As per the direction given in section 9.2 of the circular, actions had not been taken to obtain the approval for the organizational chart and the cadre.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(iv)Section 02 of the Public Enterprises Circular No. PED 01/2015 (i)(amended) dated 27 October 2016	Without get approved the carder and SOR in of the company as required by the circular, the company had paid vehicle allowances and fuel allowances amounting to Rs.17.94 million and to Rs.8.56 million respectively for 36 employees of the company during the year under review.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(v)Section 3.5 of the Public Enterprises Circular No. PED 1/2015 dated 25 May 2015	Contrary to section 3.5 of the circular, the Chairman of the Company had been used two vehicles.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.

(vi)Section 9.3.1 of the Public Enterprises Circular No: PED/12 dated 02 June 2003	Contrary to section 9.3.1 of the circular, four employees had been released to the Line Ministry during the year under review.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(vii)Section 2.1 of the Public Enterprises Circular No. PED 3/2015 dated 17 June 2015	Contrary to section 2.1 of the circular, monthly allowances and sitting allowances aggregating to Rs.2.41 million had been over paid to the Chairman and non-executive directors of the company.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(viii) Chapter 7.4.5 of the circular no PED-12 dated 02 June 2003 on good governance of public enterprises	The management of the company should appoint a committee to verify all assets and stocks of the company as at 31 December 2018. Since the company had not been done physical verification, audit was unable to satisfy the physical existence of the cost of the assets amounting to Rs.1, 161.19 million.	Not Accepted. The dispute on applicability of PED guidelines for the company's operation is yet to be resolved. However, management follows guidelines approved by the board of directors which are in line with PED guidelines.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.
(ix)Employees' provident fund Act no 15 of 1958	The Company had paid EPF payments without considering the cost of living allowance for the period of July 2013 to December 2016. As a result, the liability borne by the company as EPF and surcharge on EPF were Rs. 68.75 million. However, no provision had been made for the liability in the financial statement of the year under review.	Not Accepted. Company has already accounted the liability on EPF amounting to Rs. 47.54. However, a provision for surcharge has not yet recognized in the financial statement which will be accounted in the next financial statements.	Action must be taken to follow Public enterprises circular with the consultation of Line ministry and the parent entity.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit after tax Rs.36.8 million and the corresponding profit after tax in the preceding year amounted to Rs. 220.4 million. Therefore a deterioration amounting to Rs. 183.2 million of the financial result was observed. The reasons for the deterioration were decreasing certified Income on projects and decreasing interest income compare with the preceding year.

2.2 Ratio Analysis

	2018	**2017**
Current Assets Ratio	1.81	1.47
Quick Ratio	1.74	1.45
Gross profit ratio	6.84%	11.7%
Net profit ratio	.87%	3.69%

As per the Current Assets Ratio and Quick Assets ratio calculated, it is observed that the company had been maintained within the acceptable range for the year under review and the preceding year.

Gross profit ratio had been decreased by 4.86 percent and Net profit ratio also had decreased by almost 2.82 Percent. It is observed that the main reason for such deterioration of the annual profitability is decreasing the revenue by 30 percent and deceasing other operating income by 35 percent compared with the preceding year.

3. Operational Review

3.1 Management Inefficiencies

Audit Issue	**Management Comment**	**Recommendation**
As per the board decision no. 2008/1109 dated 01 August 2008, of the Road Development Authority, the board had decided not give any projects to subcontractors. However, out of 3,382 the projects received by the company only 185 projects equivalent to 5.4 per cent had been directly completed by the company during the period 2008 to 2018 and 3,197 projects had been completed by subcontractors during such period.	No comment	Company should carry out its construction works which have been under taken from the Road Development Authority to comply with the board decision no. 2008/1109 dated 01 August 2008.

4. Accountability and Good Governance

4.1 Submission of Financial Statements

Audit Issue	Management Comment	Recommendation
Submission of financial statement of the company had been delayed in five months from the due date.	No comments	The company should submit its financial statements on due date as prescribe by the national Audit act No.19 of 2018.

4.2 Annual Action Plan

Audit Issue	Management Comment	Recommendation
The Company had not been prepared an Action Plan.	No comments	Annual Action Plan should be prepared and review its progress periodically by the management of the Company.

4.3 Audit Committee

Audit Issue	Management Comment	Recommendation
Audit and management committee had not been established with correct composition by the company with the concurrent of the line Ministry and the Road Development Authority.	No comments	Audit Committee and management committee should be established with correct composition with the concurrent of the line Ministry and the Road Development Authority.

4.4 Budgetary Control

Audit Issue	Management Comment	Recommendation
An annual budget had not been prepared by the Company	No comments	Annual Budget should be prepared as a tool of control and reviewed periodically to achieve the objectives of the company.