

1.1 Qualified Opinion

The audit of the financial statements of the State Development and Construction Corporation (“the Corporation”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and statement of financial performance, statement of changes in equity and 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 *Finance Act No. 38 of 1971*. My comments and observations which I consider should be published with the annual report of the Corporation in terms of Section 12 of the National Audit Act, appear in this report.

In my opinion, except for the effects of the matters described in the basis for Qualified Opinion section of my report, the accompanying financial statements give a true and fair view of the financial position of the Corporation as at 31 December 2018, 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 based 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 Corporation’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 Corporation or to cease operations, or has no realistic alternative but to do so.

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

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

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

1.5 Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

<u>Reference to particular Standard</u>	<u>Management Comment</u>	<u>Recommendation</u>
<p>(a) LKAS 01 – Presentation of Financial Statements: Credit balances of Debtors amounting to Rs.39,388,893 had been offset against the debit balances of such accounts while debit balances of Mobilization advances and Creditors totaling to Rs.521,242,734 had been offset against the credit balances of such accounts as at 31 December 2018 contrary to the provision in LKAS 1 – Presentation of financial statements. Hence, current assets and current liabilities had been understated by Rs.39,388,893 and Rs.521,242,743 respectively.</p>	<p>Facts mentioned under these observations are accepted and it is noted to submit debit and credit balances separately when preparing financial statements for the next year.</p>	<p>Due attention to be paid to bring all balances to the financial statements in order to avoid possible material misstatements</p>

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| <p>(b) Fully depreciated assets approximately costing to Rs.17,844,731 are being continuously used by the Cooperation without reassessing the useful economic lifetime of those assets and accounted them accordingly as per the provisions in Section 51 of LKAS 16 – Property, Plant and Equipment.</p> | <p>It has been noted to make arrangements do a preliminary assessment in the year 2019 and a reassessment in the year 2020 with the assistance of Valuation Department.</p> | <p>The residual value and useful life of an asset shall be reviewed at least each financial year end and if expectations differ from previous estimates, the changes shall be accounted for as a change in an accounting estimate.</p> |
| <p>(c) According to the assessment notices received up to 2015 from Department of Inland Revenue (IRD) sums of Rs.338,733,800 and Rs.115,003,889 were shown as payable balance of Value Added Tax (VAT) and surcharges on VAT respectively as at the end of the year under review. However, provision for surcharges on VAT had not been made in the financial statements of 2018.</p> | <p>Please consider that, it has been noted to make provisions for surcharges on VAT in the financial statements from the year 2019. Due to lack of funds corporation was unable to pay VAT and surcharges for a considerable time period. However corporation had made appeals to the Island Revenue Department to waive off VAT payable against withholding tax receivable to the corporation.</p> | <p>Actions should be taken to made accurate provision in financial statements.</p> |

1.5.2 Accounting Deficiencies

Audit Issue

According to section 02 of the Economic Service Charges Amendment Act No.13 of 2015, Economic Service Charges (ESC) and surcharges thereon amounting to Rs.45,009,460 and Rs.13,654,032 respectively had not been paid or brought to the financial statements for the year 2018.

Management Comment

Noted to the ESC and surcharge amounts in to the Financial Statements year 2019.

Recommendation

Due attention to be paid to bring all balances to the financial statements in order to avoid possible material misstatements.

1.5.3 Unreconciled Control Accounts or Records

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
(a) An unexplained difference of Rs.4,728,291 was observed between the Value Added Tax payable balance shown in the financial statements for the year under review and the corresponding amounts shown in the detailed schedules presented for audit by the Corporation.	Difference of VAT Payable amount to the value of Rs.4,728,961/- is a cumulated amount and this originates from the year 2004. It has been noted to reconcile this difference.	Attention to be paid to reconcile the ledger balances with schedules before preparing the financial statements
(b) Difference aggregating Rs.294,253,472 was observed between the VAT payable balance, Nation Building Tax payable balance and penalty charges thereon shown in the financial statements and the respective balance confirmed by IRD.	Observations on the differences between the amounts in financial statements and amounts shown in confirmation are noted to verify and settle during this year.	Attention to be paid to reconcile the ledger balances with balance confirmed by IRD.
(c) Difference of Rs.14,665,991 was observed between the stock balance shown in the financial statements and annual stock verification summary sheets submitted to the audit for the year under review.	The difference amount of Rs.14,447,714/- should be corrected as Rs.14,665,991/- However this difference has been reduced up to Rs.6,717,762/- and further corrections are being made to clear this difference.	Attention to be paid to reconcile the ledger balances with stock verification summary sheets before preparing the financial statements.
(d) According to the financial statements of the Corporation, receivable balance shown in respect of Installation of traffic light system assigned by Road Development Authority (RDA) as at 31 December 2018 was Rs.57,313,904. However, as per the confirmation received from RDA, balance was Rs.81,218,448 which shows a difference of Rs.23,904,544.	As the corporation has not been received the total certified bills from by RDA this difference of Rs.23,904,544.00 is shown. However arrangements are being made to reconcile the difference between receivable amount from RDA for traffic light system and confirmation amount of RDA.	Attention to be paid to reconcile the receivable amount from RDA for traffic light system

1.5.4 Documentary Evidences not made available for Audit

<u>Item</u>			<u>Management Comment</u>	<u>Recommendation</u>
Item Account	of Value	Evidence not made available		
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	Rs.			
(i) VAT balances carried forward	11,362,032	Schedules and age analysis since 2013	VAT balances carried forward Rs.11,362,032/- It has been noted to verify this amount and to prepare age analysis from this year.	Schedules and age analysis should be provided for audit to satisfactorily verify and accept the VAT balances.
VAT payable balance	29,568,451	Schedules and age analysis		
(ii) Loan balance of Construction Guarantee Fund	20,800,000	Loan Agreement	Loan balance of Construction Guarantee Fund Rs. 20,800,000/- As the Construction Guarantee Fund was under the same Ministry please consider that an agreement has not been prepared.	The agreement should be prepared and submit to the audit.
iii) Refundable deposits	2,043,712	Age analysis	Refundable deposits - Rs.2,043,712/- Noted to prepare an age analysis from this year.	The age analysis should be provided for audit to satisfactorily verify and accept the Refundable deposits balances.

iv)	Purchase Advance (Peliyagoda)	21,484,694	Age Analysis	Purchase Advance (Peliyagoda) Rs.21,484,694	Noted to prepare an age analysis from this year.	– The age analysis should be provided for audit to satisfactorily verify and accept the Purchase Advance (Peliyagoda) balance.
v)	Sundry Advances	12,757,451	Age Analysis	Sundry Advances Rs.12,757,451/-	Noted to prepare an age analysis from this year.	– The age analysis should be provided for audit to satisfactorily verify and accept the Sundry Advances balance.
vi)	Sub contract Advances	15,299,042	Age Analysis	Sub Contract Advances Rs.15,299,042/-	Noted to prepare an age analysis from this year.	– The age analysis should be provided for audit to satisfactorily verify and accept the Sub contract Advances balances.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
(a) Recoverability of debtor balances of Rs.22,658,412 and Rs.14,257,844 shown in the financial statements is doubt since these balances had been remain outstanding for more than 3 years and 5 years respectively as at 31 December 2018. Further provision for impairment had not been made in the financial statements for the year under review.	Out of this construction debtor amount of RS. 253,710,931.00, It has been recovered 36% (Rs.13,456,136.00) by now. An amount to the value of Rs.3,404,125.00 out of total value is under legal actions and other remaining balances are under the process of recovering.	Outstanding balances should be recovered without any delay or to be take proper actions in this regard to ensure the reliability of those outstanding balances
(b) The retention receivable with related to the completed and abandoned projects amounting to Rs.111,390,740 and	Out of this remained outstanding amount of Rs.111,390,740/- an amount of Rs. 12,661,031/- has been recovered to date.	A proper mechanism should be introduced to recover the retention receivables relating

Rs.131,651,672 were outstanding between 3 to 5 years and over five years respectively and the recoverability of such balances are in doubt.

An amount of Rs. 24,578,219 is to be received from Road Development Authority in Southern Province is not in a position to get recover due to lack of funds with that Authority. Remaining balance from the total receivable amount is under the process of getting recovered.

to projects which completed long ago without further delay

(c) Liquidated damages receivable from subcontractors amounting to Rs.31,088,182 and Rs.57,230,998 shown in the financial statement of 2018 had remained outstanding for the period of 4 to 6 years and over 6 years as at 31 December 2018. But, Cooperation had not taken action to recover those receivable balances.

Actions are being made to settle these receivable amounts of Rs.31,088,182/- and Rs.57,230,998/-.

A proper mechanism should be introduced to recover the Liquidated damages receivables relating to projects which completed long ago without further delay

(d) The advance payment made to the suppliers amounting to Rs.903, 070 had remained over 05 years without taking any action to recover even up to 31 December 2018.

Actions are being taken to find out and settle this amount in this year.

Actions to be taken to recover the advance payment made to the suppliers without delay.

1.6.2 Payables

Audit Issue

Management Comment

Recommendation

a) Mobilization advances received amounting to Rs.15,523,744 with regard to 11 completed construction projects and suspended projects had remained in the accounts as at 31 December 2018 without been settled. The possibility for settlement of these advances is in doubt.

Noted to take suitable actions in the year 2019.

Actions to be taken to settle the all possible long outstanding mobilization advances without delay.

b) Outstanding loan balance of Rs.20,800,000 had been shown in the financial statements of 2018 from Construction Guarantee Fund. In addition to that, payable an interest balance of Rs.99,127,060 is shown in

This loan outstanding balance amounting Rs.20,800,000/- has not been settled to the Construction Guarantee Fund due to the lack of funds. Where the interest amount is concerned Corporation is under discussion with Construction

Actions to be taken to settle the all possible long outstanding loan balance without delay.

the financial statements of 2018 relating to the above loan balance. Action had not been taken to settle the outstanding balances.

Guarantee Fund to waive off that amount as it is also under the same Ministry.

- c) The advances received totaling to Rs.11,939,738 in respect of supply of concrete products shown in the financial statements had remained over 05 years as at 31 December 2018 without being settled.
- This advance amount of Rs.13,032,687/- should be corrected as Rs.11,939,738/- (2011-2013) and please consider that actions are being taken to settle this amount after scrutinizing during the year 2019.
- Actions to be taken to settle the all possible long outstanding advances balance without delay.

1.6.3 Fund utilization

Audit Issue

Management Comment

Recommendation

A Loan amounting to Rs.1,000 million had been obtained from the Bank of Ceylon during the year under review. An amount of Rs.432 million out of this loan had been utilized for the settlement of overdraft balance and Rs.273 million had been spent to pay salaries of the employees of the Corporation. In addition to that Rs.284 million was utilized for the operation of concrete yards and construction project works. Even though the corporation had expected cash inflow amounting to Rs.584 million from the aforesaid concrete yards and construction projects, the actual income received was only Rs.123 million during the year under review.

The observation is correct out of the loan amount of Rs.1000 Million Rs.273 had been spent for salaries. This amount of Rs.273 Million includes direct labour cost of employees engaged in construction projects and it has been incurred as a direct operating cost. The corporation had to obtain this loan due to the cash flow problems.

Action should be taken to maintained proper working capital management in corporation and cash flow management.

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

<u>Reference to Laws, Rules Regulations etc.</u>	<u>Non-compliance</u>	<u>Management Comment</u>	<u>Recommendation</u>
(a) Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka	(i) Financial Regulation 396	Action had not been taken in respect of 04 unrealized cheques valued at Rs.846,280 for over seven years and two un-presented cheques valued at Rs.212,527 for over one year.	Noted to verify and settle this amount of un-realized cheques valued at Rs.846,280/- Un-Presented cheques valued at Rs.212,527/- has been taken to the income by now.
(ii) Financial Regulation 156(b)	The officer at all time be responsible for the proper use of any property issued to him. However, the fixed assets valued at Rs.98 million used for road projects at Kegalle area had remained idle at sites since 2016.	Due to the objections of public, these assets were unable to move from the work site. However these assets were used up to 2016. By now actions are being taken to get those assets in to the custody of corporation and utilize these assets effectively.	Actions should be taken in accordance with Financial Regulations.
(b) Paragraph 5.1.3 at of Public Enterprises Circular No.PED/12 of 02 June 2003 on Public Enterprises Guidelines for Good Governance.	Updated Corporate Plan approved by the Board together with the updated Annual Budget had not been forwarded to the Line Ministry, Department of Public Enterprises and the Auditor General as requested.	Actions are being made to prepare the Corporate Plan from 2020-2023. Annual budget has been already prepared for the year 2019 and can be submitted.	Action should be taken to Updated Corporate Plan.

2. Financial Review

2.1 Financial Results

According to the financial statements, the operations of the Corporation during the year under review had resulted in a pre-tax net profit of Rs.18,523,726 as compared with the corresponding pre-tax net profit of Rs.12,206,658 for the preceding year, thus indicating an increase of Rs.6,317,068 in the financial results for the year under review. The increase of Revenue and Other Income were the main reasons attributed for this situation.

3. Operational Review

3.1 Personnel Management

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
(i) The approved cadre of the Corporation as at 31 December 2018 was 489 while the actual cadre was 628. Accordingly, this shows an excess recruitment of 139 employees to the Corporation to the various positions.	Audit Observation is correct. As many government projects were received for the Corporation during the year there had to recruit many employees on the basis of Casual and Contract. Management service department was informed about this situation & we have submitted a new cadre by now to the Management service department to enable us to recruit casual and contract basis employees in addition to permanent staff.	Information on the employees recruited under different categories exceeding the approved cadre of the Corporation should be submitted to the Department of Management Services for consideration.
(ii) The Corporation had recruited employees on contract basis from time to time including the officers of senior management. Two senior management personnel were recruited on contract basis during the year under review, and it had considerable affect to the performance of the Corporation. Further, 84 vacancies in approved cadre had remained vacant as at 31 December 2018.	Corporation recruited employees on contract basis and make them permanent based on their performance other than top management. Considering the professional and experience capacities Corporation recruits staff for the top management on contract basis Actions are taken to ensure this will not affect the performance of the Corporation. Further employees are recruited as per the requirements.	Corporation should evaluate the employee requirement and vacancies should be filled within the approved cadre as required.

- (iii) 737 No's sub contract labours had been employed at the end of the year under review and a sum of Rs.232,789,955 had been paid as salaries for the said labours during the year 2018.
- As a construction corporation according the capacity of work, labour requirements arrived time to time. Therefore it is difficult to recruit laborers on permanent basis and have made arrangements to get labour Services through labour contractors.
- The corporation should reconsider the necessity for deployment of outsourced manpower in addition to fixed term employees.

3.2 Operating inefficiencies

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
(i) According to the revenue recognition statement of the corporation, 15 projects had incurred losses amounting to Rs.176,424,600as at 2018.	This figure is not the actual figure because the figure of Rs.110,513,988/- had been taken by the auditors from adjustment amounts made for the year in the income statement.	The Management of the corporation should pay its attention to mitigate the financial losses and enhance the profitability.
(ii) It was observed that, the actual financial progress of the 07 Bridges, 06 roads, 07 buildings, 03 water and Electricity projects and 01 other project's progress was below 50 per cent comparing with the targeted financial progress as at the end of the year 2018.	Schedules that have been reported with the Audit observations regarding the financial progress of projects are somewhat complicated because the mentioned projects are unable to identify accurately. However most of these projects have been completed now.	The Management of the corporation should pay its attention to maintain better financial progress to refrain from cash flow issues.
(iii) It was observed that the actual physical progress was below 50 per cent compared with the targeted physical progress in respect of 04 Bridges, 05 Roads, 07 building, 05 water supply and irrigation projects and 01 other project as at the end of the year 2018. Further two road projects had shown no any progress during the year under review.	Schedules that have been reported with the Audit observations regarding the financial progress of projects are somewhat complicated because the mentioned projects are unable to identify accurately. However most of these projects have been completed now.	The Management of the corporation should pay its attention to complete the construction projects agreed time period.

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| (iv) | Pre cast concrete production orders received from outside parties valued at Rs.10,587,000 and internal orders valued of Rs.19,883,000 for the period from 2017 to 2018 had not been supplied on due dates. It was further observed that the above orders were not supplied even up to date of audit on August 2019. | Due to the exciting production capacity of this division, it was unable to supply the total amount of orders. However 83% quantity from this order has been supplied by now. | The resources should be utilized to obtain maximum capacity and action taken to remove delay charges. |
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4. Accountability and Good Governance

4.1 Corporate Plan and Action Plan

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
According to the Public Finance circular No. PFD/RED/01/04/2014/01 of 12 February 2014, the Corporate Plan for the period covering 2018 – 2021 and action plan for the year under review had not been prepared.	Actions are being taken to prepare the corporate plan from 2019-2023 & action plan is included in to the budget 2019.	Corporate plan should prepare and approved by the Board together with the updated Annual Budget should be forwarded to the line Ministry, Department of Public Enterprises, General Treasury and the Auditor General at least 15 days before the commencement of each financial year.