

State Development and Construction Corporation - 2020

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the State Development and Construction Corporation (“Corporation”) for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 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 report to Parliament appear in this report.

In my opinion, except for the effects of the matters described in paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the Corporation as at 31 December 2020, 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 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 Audit Scope

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 auditor's 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 Audit observations on the preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Noncompliance with the reference to particular Standard	Management Comment	Recommendation
<p>(a) LKAS 01 – Presentation of Financial Statements Credit balances of debtors amounting to Rs.8,562,252 and the debit balances of creditors amounting to Rs.247,182,859 had been offset against the debit and credit balances of such accounts as at 31 December 2020 contrary to the provision in LKAS 1 – Presentation of financial statements. Hence, current assets and current liabilities had been understated by Rs.8,562,252 and Rs.247,182,859 respectively.</p>	<p>Credit balances of Debtors amounting to Rs.8,562,252 will be identified separately in the next financial statements.</p>	<p>The Corporation should ensure that the entity is adherent with Sri Lanka Accounting Standards and action should be taken to reconcile the abnormal balances.</p>

- (b) **LKAS 08 – Accounting Policies, Changes in Accounting estimates and errors**
 The comparative information had not been restated and the relevant disclosures had not been done in respect of the prior year adjustment of Rs. 4,335,613 made in the changes in equity statement during the year under review as per the section 45 and section 49 of LKAS 08.
- Actions will be taken to disclose prior year adjustments separately in the next financial statements.
- The Corporation should ensure that the entity is adherent with Sri Lanka Accounting Standards and action should be taken to disclose the relevant information.
- (c) **LKAS 16 – Property, Plant and Equipment.**
 Fully depreciated computer accessories and software, Office Furniture, Machinery and Equipment, Motor Vehicle, and other Assets costing to Rs.7,665,759, Rs.11,838,574, Rs.122,478,704, Rs.180,936,809 and Rs.63,041,070 respectively 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*.
- Reassessment of fixed assets are being carried out in year 2021.
- The Corporation should ensure that the entity is adherent with Sri Lanka Accounting Standards.
- (d) **SLFRS 10 - Consolidated Financial Statements**
 Devcoshowa (Pvt) Ltd the fully own subsidiary of the Corporation had been inactive for a long time and the board had taken a decision to wind up the company in the year 2006. The winding up process was not get completed and the consolidated financial statements were not prepared by the corporation.
- As noted in the audit query Devcoshowa (Pvt) Ltd., had been inactive for a long period of time and consolidated accounts had not been prepared since its incorporation. Liquidation process is being carried out. Therefore necessary actions will be taken for the receivable balance in the winding up procedures.
- The Corporation should ensure that the entity is adherent with Sri Lanka Accounting Standards.

1.5.2 Accounting Policies

Audit Issue	Management Comment	Recommendation
Accounting policy for the provision for doubtful debts amounting to Rs.669,791,349 as at 31 December 2020 had not been disclosed in the financial statements.	Action will be taken to disclose the method used for the provision of doubtful debtors in the next financial statements.	Accounting policy should be disclosed.

1.5.3 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
(a) 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.64,158,593 and Rs.13,654,032 respectively had not been paid or brought to the financial statements for the year 2020.	Actions will be taken to identify in the next year financial statements.	Corporation should be complied with the economic Service Charges Amendment Act No.13 of 2015 and payable amount should be taken to the financial statements.
(b) Provision for Gratuity amounting to Rs.79,332,387 had been computed as at 31 March 2020 instated of 31 December 2020.	Actions will be taken in the next financial year.	Necessary measures to be initiated to ensure the accuracy of computation of Gratuity.
(c) Balance of stock adjustment amounting to Rs.19,348,787 had not been adjusted as at 31 December 2020.	In the year 2021 the stock adjustment balance has been cleared up to a debit balance of Rs.8,573,794 and actions are being taken to minimize the balance.	Stock adjustment account should be adjusted.
(d) The overvalued creditors amounting to Rs. 234,194,581 in the year 2019 had been credited to the subcontract expenses during the year under review without crediting the prior year adjustment accounts, thus understate the cost of sale and overstate the total loss.	Accounting treatment for prior year adjustment must be followed hereafter.	Necessary measures to be initiated to ensure the accuracy and reliability of accounting treatments made in the financial statements.

1.5.4 Documentary Evidences not made available for Audit

Item available	Amount	Evidence not	Management Comment	Recommendation
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	(Rs.)			
(a) Loan Balance of Construction Guarantee Fund.	20,800,000	Loan Agreement	Have a proof document instead of loan agreement.	All documentary evidence should be submitted for audit to satisfactorily vouch and accept the transactions and amount shown in the financial statements.
(b) Creditors balance	43,829,527	Individual schedule and age analysis	Actions will be taken regarding the above balances. Detail schedules have been provided as attachments to the interim audit queries.	
(c) Letter of credit Margin Account	114,127,998	Detail schedule	Detail schedules have been provided as attachments to the interim audit queries.	
(d) Sub contract advances	15,299,042	Detail schedule	Actions will be taken regarding the above balances.	
(e) Trade Creditor – Site	69,515,187	Age Analysis	Actions will be taken regarding the above balances.	
(f) Sundry Creditors	1,356,639	Detail schedule and Age Analysis	Detail schedules have been provided as attachments to the interim audit queries.	
(g) Refundable Deposits	1,201,004	Detail schedule and Age Analysis		

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue

Management Comment

Recommendation

Debtor balances of Rs.609,829,608 had remained over 03 years without being recovered. Effective actions had not been taken to recover those debtors other than the provisioning for the doubtful debts.

The corporation is in the process of collecting the remaining receivable amounts.

Action should be taken to recover the outstanding balances.

1.6.2 Advance

Audit Issue

Management Comment

Recommendation

Mobilization advances received amounting to Rs.19,177,978 with regard to 05 completed construction projects had remained in the financial statements as at 31 December 2020 without been settled since 2018.

After the retention is released actions will be taken to settle the mobilization advances.

Steps need to be taken to settle these balances.

1.7 Cash Management

Audit Issue

Management Comment

Recommendation

(a) An overdraft of Rs.10,831,519 had been obtained from the bank as at 31 December 2020 exceeding the approved credit limit.

The bank overdraft limit has been exceeded due to the bank interest cost of loan and overdraft which were not settled due to the delay in payments to be received from customers.

Actions should be taken in accordance with agreement.

(b) The bank loan outstanding as at 31 December 2020 was of Rs.1,420 million and the interest expense for those loans was Rs.164,565,105. This interest expense represents 78 percent of the total financial expenses of the year.

The corporation had to obtain huge amount of loans in the last years due to the working capital requirements and as a result corporation had to pay huge interest cost for the loans.

Actions should be taken to minimize interest expenses by using suitable strategies.

- (c) Although the budgeted net cash flow from operating activities for the year under review were Rs.1,002.64 million, the actual net cash flow from operating activities were negative balance of Rs.85.18 million. It was 108 per cent decreased when compared with the budgeted amount.
- Due to COVID 19 situation high cost of operation in construction work and financial difficulties faced by the corporation, it was not possible to achieve the budgeted profit and the budgeted cash flow for the year 2020.
- Action should be taken in accordance with plans.

1.8 Non –Compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
The Value Added Tax and Nation Building Tax totaling to Rs.942,436,927 and Rs.6,342,105 respectively had remained over ten years without being settled as at 31 December 2020.	Due to the financial difficulties faced by the corporation VAT and NBT had remained unsettled as at 31 December 2020 and appeals have been made to the Island Revenue Department (IRD) and based on the decision from IRD action will be taken.	Corporation should comply with the tax law.

2. Financial Review

2.1 Financial Results

Operations of the Corporation during the year under review had resulted in a pre-tax net loss of Rs.257,420,711 as compared with the corresponding pre-tax net loss of Rs.843,901,384 for the preceding year, thus indicating a increase of Rs.586,480,673 in the financial results for the year under review. Decreasing of cost of sales and increasing of other income were the main reasons for this increase of financial results.

3. Operational Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Although four bridges construction projects amounting to Rs.137.28 million and nine building construction projects amounting to Rs.361.74 million had been expected to complete during the year under review, actual progress was below 50 per cent.	Covid 19 situation in the country, high operating cost, delay in mobilization advances, financial difficulties faced by the Corporation, lack of fund allocations and environmental issues were the reason for the difference between actual and expected progress levels of projects in the year 2020.	Action should be taken to complete the project in accordance with expected plans.
(b) There were 16 bridge projects contract value amounting to Rs.1,572.65 million, received from National Housing Development Authority which should be scheduled to be completed in 2018 and 2019 had not been completed even by 31 December 2020. It was observed that physical progress of 08 projects were below 50 percent.	COVID 19 situation in the country, high operating cost, delay in mobilization advances, financial difficulties faced by the Corporation, lack of fund allocations and environmental issues were the reason for the difference between actual and expected progress levels of projects in the year 2020.	Action should be taken to complete the project in accordance with expected plans.
(c) Eight building construction projects and water supply and irrigation project where the total contract value is Rs.830.97 million, remained without any progress.	Due to the lack of fund allocations it has been remained without any progress	Action should be taken to complete the project in accordance with expected plans.
(d) A total loss amounting to Rs.186,279,697 had been identified from 17 projects as at 31 December 2020.	Project codes 1124, 1153 and 1185 generated profits. Other projects made losses due to the financial difficulties faced by the corporation, delay in projects, lack of funds and high operating cost.	Action should be taken to minimize the expense.

3.2 Underutilized Property, Plant and Equipment

Audit Issue -----	Management Comment -----	Recommendation -----
It was observed that there is an unusable motor vehicle, machinery, and equipment valued at Rs.67,133,489 remained the Head office premises in Rathmalana.	The assets value stated in the query are under repair or running condition.	Action should be taken to ensure that assets are properly utilized.

3.3 Human Recourses Management

Audit Issue -----	Management Comment -----	Recommendation -----
(a) The approved cadre of the Corporation as at 31 December 2020 was 491 while the actual cadre was 594. Accordingly, this shows an excess recruitment of 103 employees to the Corporation to the various positions.	The reason is labour requirement of the construction carried out in the year 2020.	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic basis.
(b) The approved cadre for civil engineers was 19, however 50 Civil Engineers had been recruited as contract basis. Further 28 Security officers had been recruited exceeding the approved cadre.	The reason is labour requirement of the construction carried out in the year 2020.	Action to be taken to ascertain realistic cadre levels, followed by reviews on a periodic basis.