Maganaguma Road Construction Equipment Company (Pvt) Ltd - 2021

---

1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the Maganaguma Road Construction Equipment Company (Pvt) Ltd "Company" for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 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, 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. 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 Company as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards for Small and Medium Sized Entities (SMEs').

1.2 Basis for Disclaimer Opinion

My opinion is disclaimer 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 disclaimer 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 for Small and Medium Sized Entities (SMEs') 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 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 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 skepticism 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 Company'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 Company'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 Company 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 Company and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;

- Whether the Company has performed according to its powers, functions and duties; and

- Whether the resources of the Company 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 Internal Control over the preparation of financial statements.

	Audit Issue	Management Comment	Recommendation
(a)	Even though, the prior year adjustments should be made to the Statement of Changes in Equity, Rs.325 million related to prior year had been adjusted to retain earning ledger account. Further, evidence and details related to the above adjustment had not been submitted to audit.	Agreed. We expect to correct errors and make adequate disclosures in future reports.	Steps need to be taken to rectify the error and proper disclosures need to present.
(b)	It was observed that company had maintained about 6645 accounts in the General Ledger without maintaining control accounts. Further it was observed that company had maintained 496 ledger accounts without providing an account code.	Agreed. The accounting software currently used in the company is not tailor-made system for the nature of the construction industry.	Proper authority and sound control need to implement before creation of the accounts in general ledger.

1.5.2 Non-Compliance with Sri Lanka Accounting Standards for Small and Medium Sized Entities

	Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(a)	Lease liability payable within one year amounting to Rs.6 million related to 8 vehicles had not been categorized as current liability in the Financial Statement as per the section 4.4 of SLFRS for SME’s.	Agreed. We expect to correct presentation in future reports.	Financial statements should be prepared based on SLFRS for SME’s.

(b)	Contrary to the section 18.18 of SLFRS for SMEs' the company had identified software cost amounting to Rs. 6.8 million under Computer systems category instead of being recognizing as Intangible Assets category and depreciated accordingly.	Agreed. In the future, management is expected to create a new category for intangible assets and record software-related purchases under a new class.	Financial statements should be prepared based on SLFRS for SME's.
(c)	Contrary to the section 20.9 of SLFRS for SMEs, the company had recognized leased assets amounting to Rs. 55 million under property plant and equipment category in the financial statements.	Agreed. We expect to do the correct measurement of leased assets in future reports.	Financial statements should be prepared based on SLFRS for SME's.
(d)	The company had not made any disclosures regarding 04 on-going legal cases and contingent liabilities amounting to Rs. 498 million as at 31 December 2021 as per the section 21.15 and 21.16 of SLFRS for SME's.	Agreed. We expect to disclose relevant details in future reports.	Financial statements should be prepared based on SLFRS for SME's.
(e)	The company had not recognized its revenue on stage of completion with related to revenue on construction amounting to Rs. 21,281 million shown in the financial statements as per the Section 23.17 of SLFRS for SMEs.	Not Agreed. The construction contract revenue of the company included revenue from contracts with different profit margins (5%, 10%) as well as direct construction contracts. Therefore, it could not check with construction cost and its stages.	Financial statements should be prepared based on SLFRS for SME's.
(f)	The company had not recognized deferred tax asset or liability in the financial statements as per the para 29.8 of SLFRSs for SMEs.	Agreed. We expect to recognize differed tax in future reports.	Financial statements should be prepared based on SLFRS for SME's.
(g)	Related Party Transactions disclosures had not been made in the Financial Statements as per the section 33 of SLFRS for SME's.	Not Agreed. Related party transactions in detail are mentioned in Note No. 13.1, and totals are linked to the Statement of Financial Position.	Financial statements should be prepared based on SLFRS for SME's.

1.5.3 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(a)	The opening balance of Plant and Machinery was Rs. 1,081 million as per the financial statements and as per the fixed asset register it was Rs. 984 million. Thus, there was a difference of Rs.96 million.	Agreed. We expect to correct the Asset register error in future reports.	Actions need to be taken to rectify the differences.
(b)	Plant and Machinery purchased during the year amounting to Rs.23 million was not recognized in the financial statements. As a result, non-current assets had been understated by that amount in the financial statements.	Not Agreed. Payment for fixed assets on a cash basis or lease basis is done through our Accounting system. Therefore, missing a payment entry could not happen.	Correct figures should be taken to financial statements and actions need to be taken to rectify the differences.
(c)	The company had recognized accumulated depreciation amounting to Rs. 23 million more than its cost value relevant to disposal of plant and machinery during the year under review.	Not Agreed. There is no possibility that accumulated depreciation exceeds the asset value.	Financial Statements need to be prepared correctly.
(d)	The company had recognized the project wise construction cost at the time of occurrence of the cost and re-transfer to Construction Work – In Progress when the project was not certified. Accordingly, expenditure had been treated as an asset by the company. As a result current assets and profit had been overstated by Rs. 853 million as at 31 December 2021.	Not Agreed. Recording Revenue and expenses of sub-contracting works done simultaneously when they arise, unless recognizing the completion stage.	Cost incurred should not recognize as a separate assets under financial statements.
(e)	As per the Financial Statements of the company the balance receivable and payables from the Road Development Authority was Rs. 5,786.94 million and Rs. 6,857.93 million respectively. However, as per the financial statements of the Road Development Authority, the relevant balances were Rs. 8,030.04 million and Rs.6, 016.56 million respectively. A difference of Rs. 2,243.10 million and Rs.841.37 million had been observed respectively, and the reconciliations had not been presented to the audit.	Agreed. We expect to correct the errors and made adequate disclosures in the future reports.	Actions should be taken to rectify the differences.

(f)	Value Added Tax (VAT) amounting to Rs.128.8 million and National Building Tax (NBT) amount to Rs. 2.9 million had been recognized as minus values under the other payables. Therefore, other payable had been understated by that amount in the financial statements.	Agreed. We expect to change the presentation of notes in future reports.	Actions should be taken to rectify the differences.

1.5.4 Suspense Accounts

Item	Amount Rs. Mn	Period in suspense	Management Comment	Recommendation
Trade Receivables	74.4	4 years	Agreed. We expect to make adequate disclosures in future reports.	Actions should be taken to clear the suspense accounts immediately.

1.5.5 Going Concern of the Organization

Audit Issue	Management Comment	Recommendation
Cabinet decision no. CP/23/0394/608/033 taken on 20 March 2023, ordered the secretary to the Ministry of Transport and Highways to take step to liquidate the Company. However, it had not been disclosed in the financial statement as per the section 3.9 of SLFRS for SME's.	Agreed. We expect to disclose the liquidation / going concern status in future reports.	Issue on going concern should be disclosed in the financial statements.

1.5.6 Documentary Evidences not made available for Audit

	Item	Amount Rs. Mn	Evidence not available	Management Comment	Recommendation
(a)	Vehicle Rent	532	Detailed schedule	The company has no updated schedules for every rent account.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(b)	Rent Expenses	13	Rent Agreement and detailed schedule	The company has no updated schedules for every rent account.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(c)	Fixed Assets disposal gain	13	Detailed schedule	Agreed. The company has no adequately updated fixed assets register for a long time.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018

(d)	Income Tax	92	Income Tax Calculation	Agreed.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(e)	Inventory	264	Inventory Verification Report	Agreed.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(f)	Lease Liability	13	Lease Amortization Schedule	Agreed. We expect to submit the required schedules in future audits.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(g)	Sub contract expenses	18,663	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(h)	Certified work bill receivable from RDA	2,358	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(i)	Retention Receivable	3,341	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(j)	Advance received from RDA	6,720	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(k)	Trade receivable	4,349	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(l)	Advance paid to contractors	4,354	Advance Payment Register	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018

(m)	Sub-contractor and other trade payable	6,611	Detail Schedules	Not Agreed. We couldn't provide the requested schedules as per the auditor's format since lack of the staff when the audit commenced.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(n)	Taxation	96	Tax Calculation Schedule	Agreed. We expect to present relevant documents in future audits.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(o)	Material Consumed	1,858	Stock ledger on Stock Consumptions during the period	Agreed. Due to a lack of finance staff, there are no adequate stock reports to submit to auditors at commencing the audit.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(p)	Retained Earnings as per the Trial Balance	612	Reconciliation for the retain earning adjustments	Agreed. We accept our failures of errors in adjusting retained earnings and not presenting adequate disclosures.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018
(q)	Construction Working In Progress	853	Detail Schedules	Not Agreed. Recording Revenue and expenses of sub-contracting works done simultaneously when they arise, unless recognizing the completion stage.	Comply with the para 38(1) b & 7 of National Audit Act No.19 of 2018

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

	Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a)	Public Enterprise's circular PED/12 dated 02 June 2003 Section 9.2	Department of Public Enterprises, General Treasury registered organization chart and approved cadre had not been presented to the audit.	Comment Not Received	Actions should be taken to follow the Public Enterprise Circular.
(b)	Companies Act No. 7 of 2007 Section 78	Share certificates had not been issued by the company.	Comment Not Received.	Act according to the Company Act requirement.

(c)	Section 133 (1)	Annual General Meeting had not been held from its establishment.	Comment Not Received.	Act according to the Company Act requirement.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.634,734,765 and the corresponding loss in the preceding year amounted to Rs.226,562,193. Therefore an improvement amounting to Rs.861,296,958 of the financial result was observed. The reason for the improvement was increase in revenue income mainly from the income on projects certified.

2.2 Trend Analysis of major Income and Expenditure items

Item	**2021 Rs.Million**	**2020 Rs.Million**	**Difference Rs.Million**	**Percentage of difference (%)**
Revenue	22,131	6,949	15,182	218
Cost of Sales	21,220	6,836	14,384	210
Other Operating Income	216.7	121.4	95.3	78
Admin and Establishment Expenses	455.6	332.1	123.5	37
Marketing Expenses	2.3	53.4	(51.1)	(96)
Finance Cost	35	49.8	(14.8)	(30)

2.3 Ratio Analysis

	2021	**2020**
Current Assets Ratio	1.23	1.4
Quick Assets Ratio	1.2	1.39
Gross profit ratio-Percentage	4	1.6
Net profit ratio-Percentage	2.86	(3.2)

3. Operational Review

3.1 Uneconomic Transactions

	Audit Issue	**Management Comment**	**Recommendation**
(a)	Approval had been given by the Cabinet decision no. 04/0848/004/013-I dated 18 August 2004 to enter into joint venture partnerships with Chamber of Construction Industries and National Association of contractors. However, it was observed that a private limited liability company had been established instead of being established a joint venture partnership in accordance with the said cabinet approval.	Comment Not Received	Action should be taken to act according to the cabinet approval.

(b)	Though the approval had been given by the cabinet decision No. 13/0134/505/004 dated 18 February 2013 to amend the articles of association of the company including that the majority of right of the company will be vested in treasury and the rest will be given to the Road Development Authority, the company had not amended the articles of association.	It was the responsibility of the Line Ministry to implement the same. The Former chairman informed the same to line ministry and action was not taken.	Actin should be taken to amend the articles of association of the company.

3.2 Delays in Projects or Capital Work

Audit Issue	Management Comment	Recommendation
In relation to the work orders of 100000 km road project, the company's target number of road construction in the year 2021 was 1934 and the length was 3010.69 km. But completed number of roads was 774 and the length was 1106.11 km as at 31 December 2021. Accordingly, it was observed that the overall progress as at 31 December 2021 was 40 percent and the company has failed to achieve even 50 percent physical progress from the expected progress.	Due to a lack of blasting materials after the ester attack, the COVID-19 pandemic, and the economic crisis, the company could not achieve the required progress.	Actions should be taken to expedite the constructions projects within the scheduled time period.

3.3 Procurement Management

	Audit Issue	Management Comment	Recommendation
(a)	The company did not follow the procurement procedures in selecting the service providers and service providers had been registered by completing an application that included several criteria favorable to the selected service providers. Accordingly, it was observed that the company had acted without transparent manner in the selection of service providers.	The company did not follow a procurement procedure for selecting subcontractors. Sub contracts had awarded by evaluating registered subcontractors.	Action should be taken to act according to the procurement guidelines.
(b)	A percentage of profit had been added to the sub contract value of the work in addition to the Bill of Quantity which was prepared by the Road Development Authority instead of calling quotations and getting a competitive price from service providers.	Bill of Quantity had been added a fixed margin. All parties know Bill of Quantities values and fixed margin percentages. Therefore, the company is not doing competitive bidding.	Action should be taken to act according to the procurement guidelines.

(c)	It was observed that company had entered into service provider's agreements with the sub-contractors instead of being entering into contract agreements.	The company had not followed formal procurement guidelines.	Action should be taken to act according to the procurement guidelines.
(d)	In addition as per the section 5.3.5 of Supplementary 39 of the Procurement Guideline, a contractor must have C 3 grade to carry out a contract between Rs. 150 million to Rs. 300 million and C 4 grade to carry out a contract between Rs.50 million to Rs.150. However, it was observed in sample audit that there were 2 instances which exceed Rs.150 million and 6 instances which exceed Rs.50 million and the contract was awarded to C 7 grade contractors.	Not Agreed. Financial limit for each grades are amended by cabinet paper number 20/1952/319/018 dated 26.11.2020. Maximum financial limit for C4 grade increase up to Rs. 900 million and C3 grade increase up to Rs. 1500 million.	Action should be taken to act according to the procurement guidelines.
(e)	The clause No. 3(e) of the service supply agreement stated that the performance security shall be 10 percent of the estimated contract value. However, it was observed that performance security had been obtained by the company only for the 145 work orders to the value of Rs. 1,113 million out of 1753 work orders amounting to Rs. 125,730 million.	Comment Not Received.	Action should be taken to act according to the procurement guidelines.

3.4 Defects in Contract Administration

	Audit Issue	Management Comment	Recommendation
(a)	The Road Development Authority has awarded 2481 work orders amounting to Rs. 193,518 million to the company for the construction work of 100,000 km road project in the years 2020, 2021 and 2022. Out of that 2481 orders 351 work orders amounting to Rs. 32,736 million had been cancelled and the construction work of 306 orders amounting to Rs. 29,130 million had not been started. Contractual works of 71 orders amounting to Rs. 5,920 million had been undertaken by the company to directly carry out, and it was only 03 percent of the total work orders. It was further observed that the remaining 1,753 orders equal to 97 percent of total orders value amounting to Rs. 125,730 million were carried out through outside service suppliers, though the awarding sub contracts was contrary to the board paper dated 01 August 2008 of Road Development Authority.	This is relevant to the Road Development Authority.	Contract awarding need to be complying with the open competitive bidding process.

(b)	The Road Development Authority had awarded work orders to the company on the contract value determined by adding a profit margin of 25 percent to the HSR. As per the company's Board Decision, the contract was offered in Lump sum method to the service providers and service providers receive a profit margin of 20 percent of the value specified by the work orders and 05 percent kept by the company. Accordingly, it was observed that, the company has earned Rs. 652 million as per the Financial Statements for the year under review only by acting as an intermediary between the Road Development Authority and the service providers without intervening in the project activities.	Comment Not Received.	Government funds should utilize in efficient and effective manner in order to get the maximum benefit to the government.
(c)	Even though, the company executed a large number of contracts, contract register had not been maintained.	Not Agreed.	Company should maintain a contract register.
(d)	The company had recruited provincial, district and zonal coordinators to evaluate the road construction progress of 100,000Km road project during the year 2020 and the company had incurred Rs.39 million during the year 2021 as payments to the coordinators. However, details relevant to the recruitment of the coordinators and progress reports provided by the coordinators had not been submitted to the audit. Therefore, audit could not verify whether the qualified personnel were recruited in a proper and a transparent manner or coordinators had been paid after evaluating the progress of the work.	Not Agreed. Coordinators were selected on instructions of local government representatives. The company has followed a formal recruitment procedure, and their qualifications were evaluated.	Coordinators should pay after the evaluating the progress of their works and relevant details should need to be furnished to the audit.

3.5 Utilization of Resources of Other Organizations

Audit Issue	Management Comment	Recommendation
Road Development Authority had released 14 vehicles to the Company for the usage of these coordinators. However, these assigned vehicles had not been transferred in a formal procedure and the recruitment procedure of drivers had not been presented to the audit. Further log books or running charts had not been maintained for these vehicles.	Not Agreed. Drivers are recruited by formal procedure, and vehicles are assigned to Drivers.	Actions should be taken to secure the protection of the government assets and vehicles should be maintained in a proper manner.