

Construction Guarantee Fund - 2021

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the Construction Guarantee Fund for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 and the statement of financial performance, statement of changes in net assets 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(3) 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 provisions in Section 11 (d) of the Trust Deed of the Fund. 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 Fund as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.2 Basis for Qualified Opinion

I expressed qualified opinion 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 Public Sector 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 Fund'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 fund or to cease operations, or has no realistic alternative but to do so.

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

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

1.4 Auditor's Responsibility 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 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 Fund'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 fund'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 Fund 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 Fund, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the fund has complied with applicable written law, or other general or special directions issued by the governing body of the Fund;
- Whether the Fund has performed according to its powers, functions and duties; and Whether the resources of the Fund 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 Observation	Management Comment	Recommendation
-----	-----	-----
In the absence of proper internal control system to identify the direct deposits made to the bank accounts of the Fund, such direct deposits amounting to Rs.12,699,286 recorded in six bank accounts of the Fund during the years from 2018 to 2021 had been recognized as unidentified credits in the statement of financial position as at 31 December 2021 without being identified and making relevant accounting entries to the books of accounts.	The Fund takes steps to identify the depositors and is in process of obtaining further information from the banks too in order to understand the depositors. A complex exercise is already initiated and identified approximate Rs.3 million out of the total Rs.12 million and may take substantial time and continue the effort.	Action should be taken to identify the direct deposits made to the bank accounts and record them in the relevant accounts without delay.

1.5.2 Non-Compliance with Sri Lanka Public Sector Accounting Standards

Non Compliance with the reference to particular Standard	Management Comment	Recommendation
<p>The fully depreciated assets such as Office Equipment & Others, Computer, Accessories & IT Equipment and Furniture, Fittings & Fixtures costing Rs.8,181,160 representing 35 per cent of the total cost as at 31 December 2021 are being continuously used by the Fund without reassessing the useful economic lifetime of those assets as per the provisions in paragraph 65 of SLPSAS 07 - Property, plant and Equipment and rectifying the estimation error and showing accurate carrying value in the financial statements as per the SLPSAS 03 – Accounting Policies, Changes in Accounting Estimates and Errors. Therefore, the fair value of those assets had not been reflected in the financial statements for the year under review.</p>	<p>The Fund considering five years as the life span of an item and revalue every five years or if there are majority of items does in between. The last one was in the year 2014 and the next due was in year 2020 for the year 2019 which could not carried out due to the environmental issues. Therefore, once the situation normalize will carry out the process</p>	<p>Action should be taken to reassess the useful economic lifetime of the fully depreciated assets and account them in accordance with provisions of the standard.</p>

1.5.3 Accounting Deficiencies

Audit Observation	Management Comment	Recommendation
<p>(a) The Fund had reported to audit that an amount of Rs.448,842 had been erroneously recorded as disposable and destroyed item under the investment activities in the cash flow statement prepared for the previous year. However, this error had not been rectified even up to the end of the year under review.</p>	<p>It is a human error occurred at time of preparing Cash Flow. Certainly, it will adjust in 2022.</p>	<p>Management should pay its attention to rectify the accounting errors in the financial statement of the following year.</p>
<p>(b) It was observed that the depreciation of Computer Accessories & IT Equipment for the year 2021 had been computed erroneously and as such the depreciation for the year 2021 had been overstated by Rs.223,668. Hence, the written down value of the PPE and surplus for the year under review shown in financial statements were understated by the similar amount.</p>	<p>Noted the errors highlighted which we duly attended to make correction</p>	<p>Management should pay its attention to rectify the accounting errors without any delay.</p>

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Observation	Management Comment	Recommendation
(a) Out of receivable income from bonds and guarantees amounting to Rs.81,621,647 as at 31 December 2021, sums of Rs.13,411,839 and Rs.352,931 had remained in the accounts without being recovered between 01 to 03 years and for over 03 years respectively.	As a policy the Fund, accept delayed payments which is part of the concessional benefit given to the Construction Contractors. Since 2017 the Employers continuously defaulted in meeting legitimate payments to Contractors. Therefore, the Fund cannot recover those. The situation further aggravates during 2020, 2021 and even in 2022 where with available information. The Fund presume that more years will take to recover those.	Action should be taken to recover the remaining balances of receivable income from bonds and guarantees without any delay.
(b) The outstanding bills discounting balance as at 31 December 2021 was Rs.10,755,461. Out of which Rs.10,663,441 or 99 per cent had remained unrecovered from one contractor for last 02 years. Hence, this amount should be recovered from the responsible persons after conducting proper investigation.	The Fund with good intention assist contractors by way of undertaking, assurance and provided funds to bridge the cash inflow to projects where there may be a delay in recovering. The Employers also have the freedom to demand the Bonds and Guarantees as those are on demands. Under this situation there may be instances after Bills Discounting to project due to Employer negative attitude could demand where the Fund has to obliged with a situation the recovery could/could not be made. In such instances to recover from contractors institute litigation and in situation and due to lack of government allocation, the Fund has to wait to recover such amount.	Appropriate action should be taken to recover the outstanding amounts from the contractor.
(c) Even though the Demand Debtors aggregating Rs.88,624,386 relating to the period of 2011 to 2021 have to be recovered from the contractors by the Fund, out of that only Rs.884,323 or 1	During last two decades few Guarantees demanded by the Employers resulting the Fund to institute Arbitration to recover such money as the contractors not	Fruitful actions to be taken to recover the long outstanding demand debtors in order to mitigate the

per cent had been recovered during the year under review. Meanwhile, the Fund had not taken fruitful action to recover this balance and mitigate the risk of un-recovery unless made a provision for impairment amounting to Rs.75,674,224 or 85 per cent of the total outstanding balance in the financial statements as at 31 December 2021. Further, the Demand Debtors totaling to Rs. 4,676,308 also had been written-off during the year 2019 without obtaining proper approvals.

refunded the money paid by the Fund to Employers. risk for default.

In this process in most of the cases, awards are received in favour of the Fund and contractor not refunded hence spite of the Awards the Fund has to go further mile to High Court and to the Supreme Court where most of the cases are pending which may take several years with substantial money spent to recover.

Therefore, the Fund cannot predict the exact duration of the recovery.

1.6.2 Payables

Audit Observation	Management Comment	Recommendation
-----	-----	-----
The negative balances totaled to Rs.11,694,080 included in income receivable from Bonds and Guarantees had been treated as payables as at 31 December 2021 and this amount included 11 negative balances aggregating Rs.3,431,981 identified in the previous year audit report. Hence, the settlement of these negative balances is doubt in audit.	Since January 2022 action been taken to reconcile and by now most of being identify and in the process of rectify the rest.	Action should be taken to reconcile and promptly identify the negative balances.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
-----	-----	-----	-----
(a) Deed of Trust of the Fund dated 05 August 1999 - Section 9(f)	The Trustees shall not be entitled to receive any salary allowances but may be reimbursed any expenses incurred in performing their duties. In contrary to that, the Fund had paid a monthly fixed amount totaled to Rs.2,500,000 during the year	After careful evaluation of the responsibility & performance of Trustees in their office, the Board of Trustees pre assed and unanimously approved	The Fund should act in accordance with the provisions of the Deed of Trust of the Fund.

under review as Reimbursement to reimbursement the for Performing of Duties. expenses. However, the details of Accordingly, this expenditure incurred for payment made on performing of duties by the monthly basis could Trustees had not been provided be justified. for audit. It was further observed that no disclosure regarding these related party transactions had been made in Financial Statements.

- (b) Financial Regulation 876 (3) issued by the Public Finance Circular No. 01/2020 dated 28 August 2020.
- If there are reasonable grounds for maintaining any non-statutory fund furthermore, such funds should be legalized by an Act of Parliament. However, the Guarantee Fund had not complied with this requirement even as at 31 May 2022.
- The Secretary to the Ministry of Finance being delegated and formed a Trust where the Secretary to Treasury (ST) as the Settler will no doubt take appropriate action when the need arises. Fund should be complied with the requirements of the Circular.

1.8 Investment Management

Audit Observation	Management Comment	Recommendation
<p>The Fund had earned a net interest income of Rs. 149.06 million on short-term and long term investment of Rs. 2,333.66 million invested in Repo and fixed deposits etc. as at the end of the year under review and this net interest income is represent 48 per cent of the surplus of the year under review.</p>	<p>2015 – 2019 there was a downward trend on the construction industry. However, a boom forecasted in the construction industry in 2020 and 2021 under “Sawbagya Dekma” but unfortunately all development activities of Government has decline due to financial constraints which is beyond the Fund’s purview and with the information available cannot predict any development activities in near future. However, the liability of the Fund will reach until end 2024 and hopeful a new era with development by 2024 or by 2025.</p>	<p>The attention of the management should be paid to increase the operating income rather than increasing the other income.</p>

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a surplus of Rs.310,233,611 and the corresponding surplus in the preceding year amounted to Rs.366,657,320. Therefore, a deterioration amounting to Rs.56,423,709 of the financial result was observed. The reasons for the deterioration are decrease of income from bonds and guarantees and increase of provision for bad and doubtful debts by Rs.16,515,748 and Rs.34,421,934 respectively.

3. Operational Review

3.1 Management Inefficiencies

Audit Observation	Management Comment	Recommendation
<p>(a) The Ministry of Roads and Highways had released a sum of Rs.27,730 million during the year 2020 and 2021 to the Fund in order to implement 100,000 km Rural Road Project. However, out of that, an amount of Rs.630 million had been withheld with the Fund as at 31 December 2021 without being released to the respective contractors. For the implementation of the above project, the Fund has provided necessary Bonds and Guarantees to 288 selected contractors up to 31 December 2021 and the numbers of road works to be completed by those contractors were 951. Out of that, only 149 or 15.6 per cent roads contraction works had been completed by 31 December 2021 and the physical progress of the other contract works was only 51 per cent as at that date.</p> <p>Further, No agreements or Memorandum of Understanding (MoU) had been entered into with the Ministry of Roads and Highways to implement the above Road Development Project with the assistance of the Fund.</p>	<p>The Fund came to an agreement in verbal to provide Bonds and Guarantees to the Contractors nominated by the Employer and both parties agreed to channel all contractor payments through the Fund and to release after ascertain the physical and financial progress of all contracts undertaken by the contractors.</p> <p>Further, this requirement is incorporated as a special term in the respective Bonds and Guarantees which is an agreement with the Employer.</p> <p>The Guarantor always has directly obligation to the Employer according the terms given because the demands to meet without any argument.</p>	<p>An agreements or Memorandum of Understanding (MoU) should be entered into with the Ministry of Roads and Highways by including clear conditions in this regard and the Fund should take necessary actions to ensure the completion of construction works within the specified time period in order to mitigate the risk of increasing the demand debtors.</p>

- (b) In addition to the matter pointed out in (a) above, a sum of Rs.85,695,106 was received from various parties to release to other contractors as at 31 December 2021 and out of that, sums aggregating to Rs.7,162,781 and Rs.1,776,129 had not been released to the respective contractors between 03 – 05 years and for over 05 years respectively. Hence, the obligation for the future settlement of these money could not be ascertained in audit.
- The contractor payments are retained with the Fund for a period until satisfy and minimize the RISK. The prevailing situation in the industry has proved that neither the Employer nor the Contractor can predict the successful completion projects as almost all construction projects irrespective of whether funded under GOSL or Donors have time overrun and cost overrun resulting some with incompleteness of scope and not reach the expected benefit to the mass. This situation has caused to retain contractor money with the Fund for a substantial time until minimize its RISK and the Liability.
- The money received from the employers should be released to the respective contractors as soon as possible.
- (c) The Fund had entered into an agreement with the Sri Lanka Telecom during the year 2015 for the Development of Management Information System (MIS) to the value of Rs. 2,984,000. Out of that first and second instalment of Rs. 2,088,800 or 70 per cent of the contract value had been paid to the Sri Lanka Telecom in the year 2015 and 2016. However, this MIS had not been completed and operated even up to 31 May 2022.
- After a careful assessment the Fund has found the money already paid as advance could set off for the part of the package presently in use but as the full package not fully implemented demanded total payment made. After notify the Board of Trustees, cancelled and demanded the full payment already made. The Fund in its own assessment satisfied with the part of exercise already made to compensate the money paid to them. Therefore, the Fund has no loss, but loose the complete project therefore demanded full payment.
- Effective actions should be taken to complete and operate the MIS without any further delay.
- (d) According to the Corporate Objectives of the Fund it was planned to develop a computerized accounting system (QuickBooks or QB) within the Organization. However, the Fund couldn't achieve this objective during the last three years although a sum of Rs.160,000 was incurred for purchase of QB. As a result, the Fund is still recorded its entire transactions manually and in excel sheets. Hence, the cost incurred for purchase of QB has become a fruitless expenditure.
- The Fund after failing the provider for an IT solution, considering the volume of work, and to minimize the manual work to an extend purchased a semi-automated readymade package which should have continuously update and to continue but due to displacement of staff during 2020 and 2021 could not maintain the continuity.
- The Fund should take action to obtain maximum benefit from the money spent.

- (e) The Fund was established in 1999 and received a Capital Grant of Rs.55,000,000 from the General Treasury in four instances during the period of 2000 to 2005. Therefore, the entire net profit or portion of the profit earned by the Fund should be remitted to the General Treasury in every year. However, the Fund had not remitted even a cents to the General Treasury since its inception although a retained profit of Rs. Rs.602,518,233 with held in the Fund as at 31 December 2021. Further, out of the retained earnings as at 01 January 2021, an amount of Rs. 500,000,000 has been transferred to an account naming “Provision for Infrastructure” during the year under review without obtaining the approval from the General Treasury.
- The GRANT and the savings used to enhance the Threshold to provide the service. As a result no excess funds in hand.
- Since the Fund is a fully owned government entity, the entire surplus or portion of the surplus earned by the Fund should be remitted to the General Treasury annually.
- Since its inception organization rented out a limited space and several attempts made in the past to establish its own secretariat and for this purpose with the concurrence of the Board of Trustees, an allocation was made.

3.2 Procurement Management

Audit Observation	Management Comment	Recommendation
-----	-----	-----
(a) The Fund had not prepared a Master Procurement Plan and a Procurement Time Schedule for year 2021 as per the guidelines 4.2 and 4.2.2 of Procurement Guidelines of Democratic Socialist Republic of Sri Lanka – 2006 even though the Fund had procured the fixed asset items worth Rs.6,061,011 during the year 2021.	The Fund already had a procurement plan and time schedule for the year 2021, and at the request of Auditors already submitted for audit purpose.	The Fund should prepare the Master Procurement Plan and a Procurement Time Schedule in accordance with the provisions of the Procurement Guidelines.
(b) The Fund had not obtained minimum three quotations in 11 instances for the procurement worth Rs. 878,321 made in the year under review in terms of provisions of the Procurement Manual 2.14.1 – 2006. As a result, the opportunity to obtain financially the most advantageous and qualitatively the best services and suppliers for the entity could not be achieved.	Although the Fund circulated quotations among registered/ selected suppliers most of the time, none of them tend to give quotations with a fair period of validity and the price varying drastically.	Fund should act in accordance with the provisions of the Procurement Manual.

4. Accountability and Good Governance

4.1 Tabling of Annual Performance Report in Parliament

Audit Observation	Management Comment	Recommendation
According to the Financial Regulation 877 (2) (e) issued by the Public Finance Circular No. 01/2020 dated 28 August 2020, the Accounting Officer of the Fund shall prepare the Annual Performance Report in all three languages under the prescribed provisions, and aforesaid report to be tabled in Parliament within 150 days after the end of each financial year. However, the Fund had not tabled its Annual Performance Reports for the year 2020 and 2021 in Parliament even up to the date of this audit report.	All Annual Reports are included with performance progress and prepared since year 2000, copies regularly sent to the Settlor and steps taken to translate into other two languages and readily available. The Fund has no access directly to Parliament therefore channel all documents through DG (Public) Finance and Settlor. The Secretary to the Treasury, Ministry of Finance for onward transmission to respective Authorities/Bodies.	Annual Performance Reports Should be tabled in Parliament as per the instructions given by the Circular.

4.2 Internal Audit

Audit Observation	Management Comment	Recommendation
According to Section 40 (1) of the National Audit Act No.19 of 2018, although the all activities performed by the Guarantee Fund should be subjected to the internal audit, the Fund had not appointed a qualified auditor to perform the internal audit functions within the organization.	In-house internal audit Committee consists with few officers of the staff and continuously conducts the internal audit. When identify the short comings rectified those immediately but no record maintain. Due to instant action unfortunately from mid-2020 could not continue the process regularly and action being taken to reinstate the process once the situation comes to normal.	Activities performed by the Fund should be subjected to the internal audit.

4.3 Budgetary Control

Audit Observation	Management Comment	Recommendation
-----	-----	-----
<p>According to the Financial Regulation 877 (1) (c) issued by the Public Finance Circular No. 01/2020 dated 28 August 2020, the budget prepared for the ensuing year should be remitted to the Director General of National Budget before 30th September of the current year for obtaining the approval thereof. However, the budget of the Fund for the year 2021 had been submitted to Auditor General only on 21 January 2022 without being obtained the required approval as per the provision in the above Circular.</p>	<p>In respect of the budget for the year 2021 was approved by the Board of Trustees in the month of June in 2020 and on request forwarded to the auditors on 21st January 2022.</p>	<p>Budget should be prepared in the prescribed format of the Circular and it should be remitted to the Director General of National Budget before 30th September of the current year for obtaining the approval thereof.</p>