

State Engineering Corporation of Sri Lanka - 2018

1. Financial Statements

1.1 Qualified Opinion

The audit of the financial statements of the State Engineering Corporation of Sri Lanka (“Corporation”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of compressive 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 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 2018, and of its compressive income 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 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 Observation on preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Reference to particular Standard	Management Comment	Recommendation
<p>(a) LKAS - 01, Presentation of Financial Statements</p> <p>According to Paragraph No.32 of the Standard, the assets and liabilities, and income and expenditure should not be off set against each other unless required or permitted otherwise by the Sri Lanka Financial Reporting Standards. However, the debit balances in the trade payables, mobilization advance received accounts, sub-contractor’s payables and accrued accounts had been offset against the credit balances of those accounts. Hence, the credit balances of such accounts had been understated</p>	<p>Steps have been taken clear all debit balances in the financial year 2020.</p>	<p>The corporation should ensure that the entity is adherent with Sri Lanka Accounting Standards.</p>

by Rs.39,293,994, Rs.183,873,754,
Rs.155,061,389 and Rs.349,822,732
respectively.

(b) LKAS - 16, Property, Plant and Equipment

Fully depreciated machinery and equipment, furniture and fittings, motor vehicles, computer hardware and office equipment costing to Rs.830,124,061 , Rs.5,646,691 , Rs.102,931,800 , Rs.57,910,500 and Rs.45,827,272 respectively are being continuously used by the corporation 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.

No need to re-value the assets for over the useful life. The main reason is that there is no any economic advantage.

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 accounting estimate.

(c) LKAS–37, Provisions, Contingent Liabilities and Contingent Assets

No provisions had been made in the Financial Statements in respect of surcharges totaling to Rs.131,946,654 and Rs.13,924,025 imposed by the Department of Inland Revenue on unpaid Value Added Tax for the year 2010 to 2017 and NBT for the year 2016 to 2017.

The Department of Inland Revenue issued a Public notice and also informed to SEC. It is indicated that, if SEC settle the outstanding taxes on or before 31.03.2022 penalty imposed thereon will be waived off. Therefore, this contingent liability is not probable to pay in future.

Action should be taken to made accurate provision in financial statements.

1.5.2 Accounting Deficiencies

<u>Audit Issue</u>	<u>Management Comment</u>	<u>Recommendation</u>
(a) Since there were unusual credit balances of Rs.229,625,808 , Rs.20,855,040 , Rs.11,498,462 , Rs.37,250,161, Rs.180,856,217 , Rs.120,100,693 and Rs.97,774,902 in the ledger account of cheque with order advance, special cash advance, advance for services, labour sub contract advances, contract labour	Steps are being taken to clear credit balances.	Action should be taken to prepare the accounts accurately.

imprest, retention receivable and TC receivable balance respectively as at the end of the year under review, those accounts as at that date had been understated by similar amounts.

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| (b) The stock value at Ekala site was understated by Rs.2,488,994 due to a computation error. | Computation error has been rectified. | Action should be taken to prepare the accounts accurately. |
| (c) Impairment of debtors had been overstated by Rs.1,260,672 due to computation errors as at end of the year under review. | Computation error has been rectified. | Action should be taken to prepare the accounts accurately. |
| (d) The depreciation of office equipment in National Equipment and Machinery Organization (NEMO) had been understated by Rs.1,607,245 due to computation error. | NEMO has not replied their observations yet. | Action should be taken to prepare the accounts accurately. |
| (e) Even though, the land and building valued at Rs.110.2 million shown in the financial statements had not belonged to the NEMO, accumulated depreciation of the building amounting to Rs.5,010,817 and depreciation of Rs.889,909 for the year had been shown in the financial statements for the year under review. | NEMO has not replied their observations yet. | Action should be taken to prepare the accounts accurately. |
| (f) A difference of Rs.70,979,175 was observed between the inter-group balance shown in the financial statements of the corporation and NEMO. | Steps are being taken to reconciled inter Current Account balances between NEMO and SEC. | Attention to be paid to reconcile the inter group balance before preparing the financial statements. |
| (g) A difference of Rs.116,257,437 was observed between the receivable balance from Sri Lanka Railway as per the financial statements and balance confirmation received from Sri Lanka Railway as at 31 December 2018 and actions were not taken to rectify the balance . | Steps are being taken to reconcile between SEC accounts with Sri Lanka Railway. | Attention to be paid to reconcile the balances before preparing the financial statements. |

(h) An unidentified deposit balance of NEMO has not replied their observations yet. Action should be taken to prepare the accounts accurately. Rs.1,328,763 relating to the period from 2012 to 2015 had remained in the Financial Statements of NEMO.

1.5.3 Unreconciled Control Accounts

<u>Item</u>	<u>As per Financial Statements</u> Rs.	<u>As per corresponding Record</u> Rs.	<u>Difference</u> Rs.	<u>Management Comment</u>	<u>Recommendation</u>
Hiring Income	79,725,302	60,899,650	18,825,652	NEMO has not replied their observations yet.	Attention to be paid to reconcile the ledger balance with schedules before preparing the financial statements.

1.5.4 Documentary Evidences not made available for Audit

<u>Item</u>	<u>Management Comment</u>	<u>Recommendation</u>												
<table border="1"> <thead> <tr> <th><u>Item of Account</u></th> <th><u>Amount</u></th> <th><u>Evidence not made available</u></th> </tr> <tr> <td></td> <td>Rs.</td> <td></td> </tr> </thead> <tbody> <tr> <td>(a) Revenue of NEMO - Building and Other Construction</td> <td>203,587,785</td> <td>Project details in profit calculation of NEMO</td> </tr> <tr> <td>(b) Inventory - NEMO</td> <td>6,781,778</td> <td>Stock verification sheets</td> </tr> </tbody> </table>	<u>Item of Account</u>	<u>Amount</u>	<u>Evidence not made available</u>		Rs.		(a) Revenue of NEMO - Building and Other Construction	203,587,785	Project details in profit calculation of NEMO	(b) Inventory - NEMO	6,781,778	Stock verification sheets	NEMO has not replied their observations yet.	<p>Project details in profit calculation should be provided for audit to satisfactorily verify and accept the projects.</p> <p>Stock verification sheets should be provided for audit to satisfactorily verify and accept the stocks.</p> <p>Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the</p>
<u>Item of Account</u>	<u>Amount</u>	<u>Evidence not made available</u>												
	Rs.													
(a) Revenue of NEMO - Building and Other Construction	203,587,785	Project details in profit calculation of NEMO												
(b) Inventory - NEMO	6,781,778	Stock verification sheets												

(c)	Advance for services - NEMO	1,282,100	Detail Schedule and Age Analysis		advance balance. Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the trade receivable.
(d)	Trade Receivable - NEMO	828,779,897	Debtor Confirmation, Detail Schedule and Age Analysis	NEMO has not replied their observations yet.	Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the labour sub contract advance. Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the labour sub contract advance.
(e)	Labour Sub Contract Advance - NEMO	18,217,056	Detail Schedule and Age Analysis	}	Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the trade payable.
(f)	Labour Sub Contract Advance (Credit Balance) - NEMO	3,632,800	Detail Schedule and Age Analysis		Age analysis should be provided for audit to satisfactorily verify and accept the sundry creditors.
(g)	Trade Payable - NEMO	262,741,890	Detail Schedule and Age Analysis		NEMO has not replied their observations yet.
(h)	Sundry Creditors - NEMO	45,479,048	Age Analysis		Detail schedules and age analysis should be provided for audit to satisfactorily verify and accept the other tax payable.

Payment vouchers and tax calculation should be provided for audit to satisfactorily verify and accept the income tax expenses.

(i) Sub contract payable - NEMO 23,949,662 Detail Schedule and Age Analysis

(j) Other tax payable - NEMO 1,851,592 Detail Schedule

(k) Income Tax Expenses - NEMO 110,859,971 Payment Vouchers and Tax Calculation NEMO has not replied their observations yet.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue -----	Management Comment -----	Recommendation -----
(a) The retention receivable balance of Rs.505,892,674 had remained for over 05 years without being recovered.	Steps have been taken to transfer retention balances to Debtors in respect of projects after completion of maintenance period.	Retention receivable balances should be recovered without any delay.

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| (b) | Trade debtors amounting to Rs.1,243,824,377 had remained unrecovered for more than 03 years and it is 46 percent of the total debtor balance. | Amounting Rs. 294.6 Mn have been recovered against Debtors during financial year 2021 & 2022, which are over 3 years. | Outstanding balances should be recovered without any delay or to be taken proper action in this regard to ensure the reliability of those outstanding balances. |
| (c) | The pre-payment balance of Rs.5,968,160 had remained over 05 years at service division without being settled. | Action will be taken in charge to income statement in year 2022 | Pre-payment balances should be settled without any delay. |
| (d) | The balance of foreign purchases control account amounting to Rs.13,734,094 had remained without being recovered at Service Division since the year 2012. | Computation error has been rectified. | Outstanding balance should be settled or rectified without any delay. |

1.6.2 Payables

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
(a) The labour sub control advances of Rs.11,568,973 had remained over 05 years without being settled.	The main reason for this issue is that, client is delaying payment due various technical matter which leads to delay in certifying the bill with regard to work done. As a result SEC is not in a position to settle contractor's payment. In future, SEC has taken all possible steps to reduce these delays	Action to be taken to settle the all possible long outstanding advances without delay.
(b) The contract labour imprest of Rs.156,390,311 had remained over 05 years without being settled.	The main reason for this issue is that, client is delaying payment due various technical matter which leads to delay in certifying the bill with regard to work done. As a result SEC is not in a position to settle contractor's payment. Finally this leads to delay in recovering mobilization advances paid to contractors. In future, SEC has taken all possible steps to reduce these delays.	Action to be taken to settle the all possible long outstanding balances without delay.
(c) The mobilization advance totaling Rs.433,417,409 received from the clients had remained over 5 years and action had	Due to various technical and other reasons most of the times projects exceeds the stipulated time periods. As	Action to be taken to settle the all possible long outstanding mobilization

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| not been taken to settle those balances as at 31 December 2018. | a result advances received by us client takes additional times to recover the full amount. Instructions have been issued to minimize the delay complete the project within time periods. | advances without delay. |
| (d) The Income tax balances totaling to Rs.10,562,150 had remained without being remitted to the Inland Revenue Department since year 2013 to 2017. | Action will be taken to settle the income tax liability coming from past payment on installment basis. | Action to be taken to settle income tax liability without delay. |
| (e) Out of the creditors balance amounting to Rs.513,102,944 , a sum of Rs.210,067,402 had remained over 05 years. | SEC is not in a position settles dues to suppliers and creditors on time due to delay in receipt of cash inflows from client mainly government institutions. Further, SEC has to incur huge fixed cost due to excess staff. Anyway SEC is trying best to settle its suppliers and creditors without delays. | Action to be taken to settle the all possible long outstanding credit balance without delay. |
| (f) Out of the subcontract payables amounting to Rs.1,440,237,909 , a sum of Rs.905,118,517 had remained over 05 years. | SEC is not in a position settles dues to suppliers and creditors on time due to delay in receipt of cash inflows from client mainly government institutions. Further, SEC has to incur huge fixed cost due to excess staff. Anyway SEC is trying best to settle its suppliers and creditors without delays. | Action to be taken to settle the all possible long outstanding subcontract payable balance without delay. |

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
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(a) Value Added Tax Act No.14 of 2002	Action had not been taken to remit the Value Added Tax totaling to Rs.748,045,632 as at 31 December 2018.	Partial Payments have been done from the total outstanding during the year ended 31 December 2018 amounting to Rs.748,045,632 which has to be paid as arrears VAT.	Action to be taken to settle the tax liability.

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| (b) | Nation Building Tax Act No. 09 of 2009 | Action had not been taken to remit the Nation Building Tax totaling to Rs.72,066,045 as at 31 December 2018. | SEC negotiates with the IRD to write-off NBT and ESC payable amounts. | Action to be taken to settle the tax liability. |
| (c) | Section 2(c) of the Circular, No. 121/1979 of 20 December 1979 issued by then Chairman of the Corporation. | Once the advances are given by way of cheques together with orders, such advances should be settled within a period of 30 days. However, such advances totaling Rs.256,635,937 had remained unsettled over 3 years at the Corporation. Further, cheque together with order advance balances given over one year amounting to Rs.20,085,988 had remained unsettled at NEMO as at 31 December 2018. | We have already informed to the officers who have undertaken the responsibility to settle the advance to settle immediately. | Due attention to be paid to comply with circular. |
| (d) | Section 4 of the Circular, No. 122/1979 of 20 December 1979 issued by then Chairman of the Corporation. | Once the cash advances are given for supply of service or goods, such advances should be settled within a period of 14 days. However, over 3 years special cash advance balances of Rs.14,263,413 had remained unsettled as at 31 December 2018. Further, special cash advance balances given over one year amounting to Rs.8,653,621 had remained unsettled at NEMO as at 31 December 2018. | Action will be taken to recover from their salary and settle the advance. | Due attention to be paid to comply with circular. |
| (e) | Treasury Circular No. 842 of 10 December 1978 | The register of fixed assets had not been maintained in NEMO as per requirement of the Treasury Circular. | NEMO has not reply the observations yet. | Due attention to be paid to comply with Treasury Circular. |

1.8 Cash Management

Audit Issue	Management Comment	Recommendation
(a) The Corporation had obtained a bank overdraft of Rs.45,430,869 in excess of the approved facility as at 31 December 2018.	We could not settle this over draft due to poor cash flow situations. However in year 2021 this exceeded over draft balances converted to loan.	Action should be taken to maintain working capital management in corporation.
(b) Out of the finance cost, 34 per cent represented the cost of interest on bank overdrafts amounting to Rs.96,826,390.	Interest cost for bank overdraft was increased due to not settle permanent over draft and interest thereon. This situation was happened due to poor cash flow situation of the corporation.	Action should be taken to maintain working capital management in corporation and cash flow management.
(c) The interest on bank loans had increased by Rs.83,317,612 or 93.8 per cent as compared with the preceding year as at 31 December 2018. As the Interest Bearing Borrowings had increased by Rs. 1,498,719,820 or 248 per cent as against the preceding year, the financial position will further weaken in case of the corporation failing to earn sufficient profit through the projects in the future.	SEC has obtained a loan of Rs. 2,100 Mn from Bank of Ceylon for working capital requirement in year 2016. Due to present Cash Flow issue SEC could not settle these loans for a longer period unless, its cash receipt improve.	Action should be taken to maintained proper working capital management in corporation and cash flow management.

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 loss of Rs.1,757,592,398 as compared with the corresponding pre-tax net loss of Rs.1,316,541,721 for the preceding year, thus indicating a decreased of Rs.441,050,677 in the financial results for the year under review. The decrease of Revenue and Other Income were the main reasons attributed for this situation.

3. Operational Review

3.1 Operating inefficiencies

Audit Issue	Management Comment	Recommendation
(a) Forty two projects valued at Rs.6,816,376,809 implemented by the	Instructions have been issued to all concern parties and to the top	The management of the corporation should pay its

- Construction Division had incurred losses amounting to Rs.508,324,458 in the year under review, and its total accumulated loss as at 31 December 2018 was Rs.996,917,817.
- management carry-out projects keeping profit margin. Also actions taken identify loss making projects using stringent progress monitoring system.
- attention to mitigate the financial losses and enhance the profitability.
- (b) Seven projects valued at Rs.327,438,891 implemented by the Construction Component Division had sustained losses amounting to Rs.30,402,903 in year under review, and its total accumulated loss as at 31 December 2018 was Rs.72,049,447.
- Instructions have been issued to all concern parties and to the top management carry-out projects keeping profit margin. Also actions taken identify loss making projects using stringent progress monitoring system.
- The management of the corporation should pay its attention to mitigate the financial losses and enhance the profitability.
- (c) Four projects valued at Rs.74,262,513 implemented by the Mechanical & Electrical Division had incurred losses amounting to Rs.1,263,361 in year under review, and its total accumulated loss as at 31 December 2018 was Rs.11,250,528.
- Instructions have been issued to all concern parties and to the top management carry-out projects keeping profit margin. Also actions taken identify loss making projects using stringent progress monitoring system.
- The management of the corporation should pay its attention to mitigate the financial losses and enhance the profitability.
- (d) A Number of 1320 concrete slippers costing to Rs.8,383,000 rejected by the Department of Railway due to lack of quality, had remained in the stock for over 05 years.
- SEC is in process of minimizing the losses by taking other alternative actions where economics value addition is feasible.
- The management of the corporation should pay its attention to quality of production and enhance the profitability.
- (e) Twenty five projects valued at Rs.554,510,917 implemented by the NEMO had incurred losses amounting to Rs.67,798,319 in year under review.
- NEMO has not replied their observations yet.
- The management of the corporation should pay its attention to mitigate the financial losses and enhance the profitability.

4. Accountability and Good Governance

4.1 Submission of Financial Statements

Audit Issue

Management Comment

Recommendation

In terms of Section 6.5.1 of the Public Enterprises Circular, No. PED/12 dated 02 June 2003, the annual financial statements and the annual performance draft report should be furnished to the Auditor General within 60 days from the close of the year of accounts. Nevertheless, financial statements pertaining to the year under review had been furnished to the Auditor General on 28 July 2021, after a delay of 735 days.

Not replied

Action should be taken in accordance with circular.