Maga Neguma Road Construction Equipment Company (Pvt) Ltd - 2020

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1. Financial Statements

1.1 Adverse Opinion

The audit of the financial statements of the Maga Neguma Road Construction Equipment Company (Pvt) Limited ("Company") for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 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 and. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, because of the significance of the matters discussed in the basis for Adverse Opinion section of my report, the accompanying financial statements do not give a true and fair view of the financial position of the Company 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 for Small and Medium Sized Entities (SMEs).

1.2 Basis for Adverse Opinion

My opinion is adverse 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 adverse 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 intends 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 financial 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
It was observed that no control over creating a ledger account through customized accounting system is being used by the company for recording transactions since 2006 and any accounting officer can create a ledger account without getting any authorization. As a result of that, there were 5,273 accounts had been created in the General Ledger out of which most of the accounts were duplicate accounts of their originals. Further to that, after posting a transaction into the system, it can be modified unless the period is locked and limits to posting a journal entry into the system had not been introduced by the management of the company.	Comment not Received	Action should be taken to introduce proper ledger posting system

1.5.2 Non-Compliance with Sri Lanka Accounting Standard for small and medium sized entities (SMES)

	Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(a)	Contrary to the Section 2 of SLFRS for SME's – Concepts and Pervasive Principles, the audit fees of Rs.4.5 million paid in December 2020 for the previous years, had been erroneously adjusted to the opening bank balance and as a result opening over draft balance has overstated by that amount.	This is adjusted to the financial statements	Cash payment should be entered to the cash book at the date of payment

(b) As per the section 10.23 of SLFRS for SME's-Disclosure of prior period errors, disclosures such as the nature of error and reasons for such error should be made in the financial statements. However, such disclosure had not been made for the retrospective adjustment amounting to Rs. 118.9 million which arose due to an error that occurred in the previous periods.	This disclosure has not been made and required explanatory note would be adjusted in note to the financial statements.	As per the standard requirements, disclosure should be made regarding prior periods errors
(C) Company had recognized its computer system amounting Rs.34.93 million as a Property, Plant and Equipment instead of recognised as an intangible asset as per the Section18-0f SLFRS for SME's Intangible assets other than Good Will. Further it was observed a difference of Rs. 28.02 million in this regard in between the Financial Statements as at 31 December 2020 and the Assets register.	Necessary adjustments would be made according to LKAS -38, recognition criteria.	As per the provision of standard intangible asset should be recognized as separate line item
(d) According to section 17.20 of SLFRS for SME's – Property Plant & Equipment, the depreciation of an asset begins only when the asset is ready for use. In contrary to that provision, the company had depreciated materials which were used to build the intended assets until 2017. However, after 2017, relevant adjustment for correction of such prior periods had not been made by the company. It was revealed in audit test check that cost of material purchased during the period 2008 to 2010 aggregating to Rs. 16.08 million had been depreciated as material at the rate of fifteen percent even for the year 2020. Therefore, depreciation had been overstated and the relevant assets had not been shown correctly under non-financial assets.	Respective corrections will be adjusted to retained earning accordingly	Depreciation should be made as the provision of standard
(e) As per the section 17.23 0f SLFRS for SME's – Property Plant & Equipment, "if there is an indication that there has been a significant change in since the last annual reporting date in the pattern by which an entity expects to consume an assets future economic benefits, that entity shall review its present depreciation method and if current expectations differ, change the depreciation method to reflect to new pattern". However, the cost of Rs. 772.34 million of assets which were fully depreciated and still being used by the company had been recognized under Property Plant & Equipment.	A valuation of assets is been doing at the moment and the report could be provided and the relevant adjustments could be done afterwards.	Entity shall review the life time of assets annually per provision of standard.

(f)	As per the Section 23.17 of SLFRS for SMEs "When the outcome of a Construction contract can be estimated reliably, an entity shall recognize contract revenue and contract costs associated with the construction contracts as revenue and expenses respectively by reference to the Stage of Completion of the contract activity at the end of the reporting period. Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectability of billings." However, it was observed that the Company had been recognized it revenues on constructions amounting Rs. 6,887 million which was 99 percent of the total revenue, on certified bills instead of billing on the Stage of completion. Further, it was observed that Interim payment certificates aggregating to Rs. 2,924.74 million relating to the works completed from the year 2014 to 2019 had been recognized as income for year under review and Interim payment certificates of Rs. 1,156.7 million relating to the work completed during the year 2020 had not been recognized as income for the year under review due to non-certification by the RDA. In addition to that it was revealed that, Interim payment of Rs. 51.1 million on works completed and certified during the year under review had not been recognized as income for the year under review. Therefore, It was observed that in recognizing revenue, company had not been followed the provision of the standard.	Completeness and accuracy of the interim payment would be verified with the project division and adjusted accordingly.	Revenue should be identified as provisions of the standard.
(g)	According to section 29.7 0f SLFRS for SME's – Income Tax, any Entity shall be recognized differed tax liability or differed tax assets for all taxable / deductible temporary differences. However, company had not recognized differed tax liability or differed tax assets. Further to that, entity had not made any disclosure in this regards.	Differed tax asset/Liability would be calculated and adjusted immediately after making adjustment for all assets and liabilities.	Company should follow the provision of the the standard regarding adjustments of differed taxes.
(h)	The contingent liability of Rs. 173 million which was claimed by PRDA through a legal case against the company had not been disclosed in the financial statement as per the section 21.15 0f SLFRS for SME's Provisions and Contingencies.	Required disclosures in the financial statement would done as per the LKAS-37	Required disclosures should be made as per the standard.

1.5.3 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(a)	A provision of Rs. 6.90 million had been made twice in the salary payable account and accrual wages account which arose from the legal Case. Simultaneously this amount had been debited twice to the salary expenditure account as well. As a, result liability and expenditure had been overstated by Rs. 6.90 million and loss has been overstated.	Reversal J-E s 23- 00741, 23-00740, correct J-E, 23-00751	Correct amount should be show in the financial statements
(b)	A working Progress aggregating to Rs.1, 284 million had been identified by the company as at 31 December 2020 and out of that Rs.463 million had been written off through a Journal entry to the cost of sales A/c and to working progress A/c. Therefore, it was observed that reasonable presentation had not been made on that written off. Further adequate disclosures had not been presented to the financial statements. Those write offs included expenditure for surfacing Harangala–Nawalapitiya Road amounting to Rs. 80 million, Kaluaggala-Labugama Road amounting to Rs. 61 million, asphalt overlying at Maithripala Sirisena Mawatha amounting to Rs. 65 million, rehabilitation of Narahenpita-Nawala-Nugegoda road amounting to Rs.35 million, asphalt overlying on Kakirihenpitiya to Ganegoda road amounting to Rs. 20 million, road edge widening on Harangala-Kalpitiya road amounting to Rs. 19 million, Unagolla-Diulewa road and improvements to Thummodara-Puwakpitiya road amounting to Rs. 18 million for each, Umandawa maha Vihara asramaya external road amounting to Rs.16 million and Mawathagama town, Kurunagala Kandy Road, Mawathagama-Barandana road amounting to Rs.15 million. Further it was observed that those written off had been made without the approval of the Board of Directors and evidence and criteria of confirming the reasonableness of each and every write off, report of the detail study identifying the steps had been taken to recover those balances and actions which had been taken to identify the responsible persons regarding such losses had not furnished to the audit.	Further reconciliation shall be carried out to finalize the accurate adjustment to the system.	Adequate disclosure should be presented in the financial statement and proper approval should be taken to written off balances.

(c)	Credit balances aggregating to 852.34 million were abnormally included in four receivable A/cs, namely Retention receivable account, Certified Work Bills Receivable accounts, Trade debtors and Work bills on construction RDA – Submission account of Rs. 271.8 million, 507.5 million, 35.1 million and 37.9 million respectively. As a result, the total assets and liabilities in the financial statements had been understated by that amount as at 31 December 2020.	The reconciliation for this is conducted.	Correct amount should be show in the financial statements
(d)	Debit balances were abnormally included in the payable balance to the Road Development Authority of Rs. 428 million and other trade payable balance of Rs.1.18 million respectively.	The relevant Journal Entries were passed.	Correct amount should be show in the financial statements

1.5.4 Unreconciled Control Accounts or Records

Description	Management Comment	Recommendation
As per the financial statements of the Company as at 31 December 2020 the balance receivable and payables from the Road Development Authority was Rs. 4,644.81 million and Rs. 2709.12 million respectively. However, as per the financial statements of the Road Development Authority, relevant balances were stated as Rs. 4017.76 million and Rs.2009.76 million respectively. Hence, differences of Rs. 627.05 million and Rs. 699.36 million respectively, had been observed and reconciliations had not been presented to the audit in this regard.	The reconciliation with the RDA will be continuing	Ledger balance should be reconciled with respective periodically.

1.5.5 Suspense Accounts

Description	Management Comment	Recommendation
A suspense creditor balance of Rs.69 million older than two years and suspense debtors balance of Rs. 23 million between year 1 to 3 year had been included in trade debtors account and it was further observed that actions had not been taken to identify and settled these abnormal balances as at 31 December 2020.	A reconciliation for the suspense creditor balance is doing by Internal Audit division and that reconciliation is not yet been finalized.	Immediate action should be taken to settle suspense balances in accounts

1.5.6 Going Concern of the Organization

Audit Issue	Management Comment	Recommendation
According to the cabinet decision no. CP/23/0394/608/033 has taken on 20 March 2023, cabinet has decided and ordered to secretory to the Ministry of transport and Highways to take step to liquidate three companies namely, Maga Neguma Road Construction Equipment Company (Pvt) Ltd, Maga Neguma Consultancy and Management Company (Pvt) Ltd and Maga Neguma Emulsion Production Company (Pvt) Ltd. Therefore, the going concern of the company is doubtful.	Comment not received	Issue in going concern should be disclosed in the financial statements.

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 Enterprises Circular No. PED 1/2015 dated 25 May 2015 i. Section 3.1	Contrary to the circular, the Company had paid fuel allowances exceeding entitle limits to 34 officers of the Company aggregating to Rs. 2.05 million during the year under review.	Comment not Received	Action should be taken to follow the public enterprises circular instruction.
(b)	Public Enterprises Circular No. PED 12 dated on 02 June 2003			
	(i) section 8.8	Document on delegation of Authority was not available in the company.	Comment not Received	Action should be taken to follow the public enterprises circular instruction.
	(ii) section 2	Approved schemes of recruitment and promotion scheme for each post was not available in the company.	Comment not Received	Action should be taken to follow the public enterprises circular instruction.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs. 226,562,194 and the corresponding profit in the preceding year amounted to Rs. 30,769,880 Therefore it was observed a deterioration of financial result amounting to Rs. 257,332,074 comparing to the previous year. The reasons for such deteriorations are increasing of cost of sale, finance cost, marketing expenses and administration expenses by Rs.3,726,696,744 Rs. 39,617,775 Rs. 29,670,927 and Rs. 23,184,221 respectively when comparing with the preceding year.

2.2 Trend Analysis of major income and Expenditure items.

Item	2020 Rs.	2019 Rs.	Change Rs.	Percentage of the change (%)
Revenue	6,948,658,803	3,363,782,643	3,584,876,160	107
Cost of Sales	6,835,733,745	3,109,037,001	3,726,696,744	120
Other Income	121,462,761	113,754,659	7,708,102	7
Administrative & Establishments Expenses	332,113,051	308,928,830	23,184,221	8
Marketing Expenses	53,486,273	23,815,346	29,670,927	125
Finance Costs	49,813,406	10,195,631	39,617,775	389

Revenue was increased by 107 per cent mainly from income on Projects – Certified. Aswell as, finance cost was increased by 389 per cent resulting of significant improvement in interest expenses on bank overdraft.

2.3 Ratio Analysis

	2020	2019
Current Assets Ratio	1.41	1.64
Quick Ratio	1.39	1.61
Gross profit ratio-percentage	1.63	7.57
Net profit ratio-percentage	(3.26)	0.91

As per the current assets ratio and quick ratio, it was observed that the company had been maintained within the acceptable range for the year under review and the preceding year.

Gross profit ratio had been decreased by almost 6 percent and net profit ratio had indicated negative rate of 3.26 percent. It was observed that the reasons for such are increasing the finance cost and marketing cost by 388 percent and 124 percent respectively.

3. Operational Review

3.1 Management Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	As per the board decision No. 2008/1109 dated 01 August 2008, of the Road Development Authority, the Board had decided to avoid giving projects to the subcontractors. However, out of 761 projects received by the company, only 48 projects equivalent to 6.3 percent had directly been done and 646 contracts had been awarded to sub-contractors by the company for the year under review. However, the	Comment not Received	Action should be taken to comply with the Board decision and enhance company income without giving sub-contracts.

	company has treated these sub-contractors as suppliers of the company. Whereas, the Notes to the financial statement 1.3.1 clearly stated the way of revenue recognition method from the sub-contractors.		
(b)	According to paragraph No. 5.4.8 of procurement guidelines, works shall require performance security of not less than five percent of the estimated contract sum to safeguard the Procurement Entity in case of a breach of contract by the contractor. However, the company had awarded contracts amounting to Rs. 23,764 million as at 31 December 2020 and simultaneously contract should submit performance securities of Rs. 1,118 million. However, the company had not obtained performance securities from the contractors and the company's procedure was to deduct 5 percent from the bill's value as the performance bond.	Comment not Received	Action should be taken to comply with the procument guideline with references to obtain performance securities and advance payment guarantee.
(c)	Paragraph No. 5.4.4 of the procurement guideline, the advance payment for any contractor shall be a maximum of twenty percent of the contract sum and as per paragraph No. 3(d) of the contract agreement supplier shall provide an unconditional on-demand bank guarantee to the company. However, it was observed that a mobilization advance of Rs. 161.2 million had been paid but only Rs.5.5 Million had been kept as advance guarantee.	Comment not Received	Action should be taken to comply with the procument guideline

3.2 Defects in Contract Administration

	Audit Issue	**Management Comment**	**Recommendation**
(a)	As at 31 December 2020, a sum of Rs. 708.1 million advance remains unsettled over 05 years. On the same date the subcontractors & other trade payable balance was Rs. 2,443.64 million. However, out of that, the balance of Rs. 513.56 million remained unsettled over 04 years. Further, a sum of Rs. 231.23 million is remained over 04 years period in the retention payable account without being settled.	Comment not Received	Advance should be settled without further delay.
(b)	As at 31 December 2020, the trade Debtor's balance of Rs. 319.80 million. Out of that balance of Rs. 147.66 million had not been recovered over 04 years. In addition to that on the same date the balance amount of advance paid to contractors of Rs. 1,210.05 million and out of which Rs. 69.93 million had remained over 05 years period without being settled.	Comment not Received	Prompt action should be taken to settle receivable balance timely.

(c) As at 31 December 2020, Retention receivable with regard to the RDA and non-RDA works was of Rs. 2,185 million out of that Rs. 1021.12 million remains unsettled over 03 years.	Comment not Received	Prompt action should be taken to settle receivable balance timely.
(d) As at 31 December 2020 receivable on certified work bills was Rs. 2,622.17 million and out of that Rs. 866.69 million remains unsettled over 03 year	Comment not Received	Prompt action should be taken to settle receivable balance timely.
(e) According to the information received from the project division as at 30 November 2022, out of 761 contracts received from the Road Development Authority and 268 contracts with a value of 18,247 million had been suspended and out of which 156 contracts with a value of Rs. 10,553 million had progress below 50 per cent.	Comment not Received	Action should be taken to expedite the construction projects without delay.