

## Construction Guarantee Fund - 2022

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### **1. Financial Statements**

#### **1.1 Qualified Opinion**

The audit of the financial statements of the Construction Guarantee Fund (“Fund”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 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 Construction Guarantee Fund dated on 05 August 1999. 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 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 2022, 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 stability 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 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 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.**

Entities are required to “devise and maintain” a system of internal accounting controls sufficient to provide reasonable assurance that , transactions are executed in accordance with management’s general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards , and to maintain accountability for assets, access to assets is permitted only in accordance with management’s general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

### **1.5.2 Non-Compliance with Sri Lanka Public Sector Accounting Standards**

<b>Non Compliance with the reference to particular Standard</b>	<b>Management Comment</b>	<b>Recommendation</b>
<p>According to paragraph 49 of Sri Lanka Public Sector Accounting Standard Number 07, when revaluing property plant and equipment the entire class of asset must be revalued. However, the Fund had revalued assets which were purchased prior to 2018 including, office equipment, other computer accessories, IT equipment and furniture. Those assets had a carrying value of Rs.0.32 million as at 31 December 2021 (costing Rs.9.62 million) which was revalued at Rs.1.93 million during the year under review.</p> <p>Furthermore, according to paragraph 42 of the standard, Revaluations shall be made with sufficient regularity to ensure that the carrying amount of property plant and equipment does not differ materially from that which would be determined using fair value at the reporting date. Despite individual inspection, the committee members had revalued the assets based on the number of years used. Therefore, accuracy of the revaluation gain of Rs. 1.61 million could not be ascertained.</p>	<p>It is planned to correct all deficiencies with the assistance of chartered assessors and conduct a complete revaluation in the year 2023 according to SLPSAS 07.</p>	<p>Appropriate methodology should be used to revalue entire class of property plant and equipment in compliance with accounting standard.</p>

### 1.5.3 Accounting Deficiencies

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
<p>(a) According to the information provided by the Fund receivable interest income from treasury bills was Rs. 0.29 million as at 31 December 2022. However, the Fund has reported Rs. 0.23 million in the financial statements. Therefore, the interest income and receivable interest income during the year under review were understated by Rs. 0.06 million in the financial statements.</p>	<p>The system will be corrected in the next year according to the instructions given for improvement.</p>	<p>Management should strive to rectify accounting deficiencies and should be kept under close supervision over the accounts.</p>
<p>(b) Debtors had deposited Rs. 1.50 million to 06 bank accounts prior to 31 December 2021. Those balances were not identified and stated as an unrecognized liability in the financial statement. As a result, receivable income from bonds and guarantees were overstated by the same amount.</p>	<p>It had been carried forward as an unidentified Credit balance. Therein, those balances have been credited to the unrecognized credit balance control account until they are debited to the cash book and recognized in 2021. During the year 2022 unidentified balance of Rs.11,198,921 has been recognized and removed from the control account and adjusted with the receivable income account balances (relevant debtor balance).</p>	<p>Bank direct deposit should be identified without any delay and recorded in respective accounts.</p>

## 1.6 Accounts Receivable and Payable

### 1.6.1 Receivables

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
<p>(a) The outstanding bills discounting balance as at 31 December 2022 was Rs.10.30 million. This was due to non-payment of bills by the employers. Out of which Rs. 10.10 million or 98 percent from Hiru Construction and Enterprises and the remaining 02 percent or Rs. 0.09 million was not recovered from Navod Construction Suppliers for more than 03 years.</p>	<p>Entered into Arbitration for the disclaimed contractors in non-reimbursed cases.</p>	<p>Payments on bills discounting should be done only after confirming the possibility of receiving the relevant money from the employers for those bills and in other cases, the officers who reached the relevant decisions would be responsible for it.</p>

- (b) According to debtor age analysis of receivable income from bonds and guarantees which was stated in the statement of financial position as at 31 December 2022 was Rs. 39.52 million. Although according to the age analysis, it was further observed that there is a credit balance of Rs. 19.06 million which was overcharged from the contractors. From the aforementioned overcharged balance, Rs.17 million had not been settled from 01 to 03 years. However, the credit balances had been included under creditor and accrued expenses in the financial statement.
- Due to the economic and other instabilities during the period of 2020-2022, non-receipt of money due from the government had a severe impact on the construction sector. Due to the same reason, Fund had to face difficulties in recovering the income due from bonds and guarantees. A prior notification has been made and the money withheld in the transit money was received from the clients to settle the bills of the contractors. Meanwhile they have made payments for it. There the debtor's credit balances have arisen.
- Actions should be taken to recover the due balances and settle the credit balances promptly.
- (c) The Fund issues Bonds and guarantees to registered contractors without keeping any security and employers demand guarantee money from the Fund in the cases of poor performance of the contractors. From 2011 to 2019, an amount of Rs. 87.65 million was paid to the employers in 22 cases, out of this balance Rs. 4.68 million could not be recovered and was written off with the approval of the Board of Trustees in 2019. Further, from 2020 to 2022 the amount paid to the employers and to be recovered from contractors to the Fund was Rs. 30.16 million. Accordingly, the sum paid by the Fund to the employers amounting to Rs. 113.13 million, had to be recovered back to the Fund by 31 December 2022.
- During the audit it was observed that there is uncertainty in the recovery of this balance of Rs. 113.13 million and a provision of Rs. 76.15 million had been made for bad and doubtful debt for these debtors. In this regard, the
- As soon as the relevant employer makes an application for demand the Fund pays the guarantees and takes steps to recover them from the contractors. In those cases, the matters extended to legal proceedings as the contractors continued to delay their reimbursement. Even now, legal proceedings are being carried out and trying to recover from the final judgment.
- Fund should focus on improving the performance of contractors and as there are cases where money is not recovered despite favorable legal decision efforts should be made to introduce an effective action.

judgments of the legal actions including arbitration were in favour of the Fund but unable to recover the related money. The Fund had been spent Rs. 0.80 million for the legal proceedings related to this in the year under review.

## 1.6.2 Payables

Audit Observation	Management Comment	Recommendation
(a) A sum of Rs. 0.14 million received from employers in 2016 had not been settled since unable to recognize relevant contractor and included in the Transit money balance as at 31 December 2022.	Unrecognized direct deposit balance in 2016. Since the amount has exceeded 05 years and the identity of the owner has not been confirmed so far, it has been decided to remove it from the accounts in 2023 with the approval of the Board of Trustees.	In the case of direct deposits a suitable mechanism should be introduced to identify the relevant contractor and unclaimed liabilities should be recognized as revenue within a reasonable time.
(b) The Ministry of Roads and Highways had given Rs.30.57 billion to the Fund in the year 2022 to pay the certified bills of 290 contractors carrying out the construction contracts under the 100,000 km rural road scheme, of which Rs.29.88 billion was released to the contractors. Furthermore, an amount of Rs. 278.83 million was retained by the Fund in the transit money account as of 31 December 2022 without being released to the relevant contractors. Out of this balance Rs.126.53 million was retained from 01 year, Rs.146.55 million from 1 to 2 years and Rs.5.75 million from more than 02 years. Moreover, the Fund did not have a formal agreement to implement more complex and risky road development project with Ministry of Roads and Highways. Also, out of the money given to the Fund by various other parties to be released to the contractors amounting Rs. 42.87 million had not been settled to the respective contractors on 31 December 2022. Out of this balance the total of Rs. 10.02 million and Rs. 17.24 million was	The Fund reached a verbal agreement to provide bonds and guarantees to the contractors nominated by the employer, and both parties also agreed to channel all contractor payments through the Fund and release them in installments after confirming the physical and financial progress of all contracts.	Fund should issue Bonds and Guarantees adhering to usual business procedures apart from that occasion's agreement should be entered with formal approval.

retained by the Fund from 01 to 03 years and 03 to 07 years respectively due to inadequate current performance of the respective projects. Therefore, the responsibility for future settlement of these amounts could not be ascertained in the audit. Thus, it was observed that it is problematic to retain the money given by the employers for settling the contractors' bills as transit money for a long period of time. Thus, the Fund had earned income of Rs. 74.55 million from investing Funds in short-term investments until released to the contractors during the year from the Funds received from the Ministry of Roads and Highways and other employers.

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

	<b>Reference to Laws, Rules Regulations etc.</b>	<b>Non-compliance</b>	<b>Management Comment</b>	<b>Recommendation</b>
(a)	Deed of Trust of the Fund dated 05 August 1999 Section 9 (e)	The Board of Trustees shall not be entitled to receive salaries, allowances or honorarial salaries but may be reimbursed for expenses incurred in the performing of their duties. However, contrary to that the Fund had paid monthly Rs. 50,000 to each trustee, as a fixed sum and aggregating to Rs. 2.50 million and Rs. 2.30 million during the years 2021 and 2022 respectively has paid. Nevertheless, the details of the expenses incurred by the Board of Trustees for the performance of their duties were not disclosed in the financial statements and those details were not submitted to the audit. Furthermore, no disclosure was made in the financial statements regarding these related party transactions.	The trustees are directly bound on behalf of the subject Nos. 07, 08 and 11 of the trust deed, and their additional duties have been identified. It should be considered as an expense incurred on behalf of performance of duties	The Fund should complied with the provisions of the trust deed

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| (b) | Financial Regulations 876(3) issued by Public Finance Circular No. 01/2020 dated 28 August 2020 | If there are any reasonable grounds for continuing non statutory Fund, the Fund should be legalized by an Act of Parliament. However, the Fund had not complied with this requirement even by 31 March 2023.                                                                                                                                                                                     | The Fund had established by the Secretary of the Ministry of Finance. The Fund expected that the Secretary of Treasury as the Settlor of the Fund will take further legislation or appropriate actions as required.                                                 | Actions should be taken to comply with the requirements mentioned in the circular.   |
| (c) | National Audit Act No. 19 of 2018 41(1)                                                         | Although the Fund should conduct audit and management committees to review the operational activities of the Fund and timely report to the Board of Trustees, the Fund never held an audit and management committee meeting. Additionally, the Fund had not participated in the audit and management committee meetings of the Ministry of Finance, Economic Stabilization and National Polices. | The performance report of each year is submitted to the Settlor consecutively in the month of January of the following year after the approval of Board of Trustees. We strongly believe that the Settlor holds the clauses of submitting the report to Parliament. | The Fund should take steps to comply with the requirement mentioned in the circular. |

## 2. Financial Review

### 2.1 Financial Result

The operating result of the year under review amounted to a surplus of Rs. 285,269,552 and the corresponding surplus in the preceding year amounted to Rs. 310,233,611. Therefore deterioration amounting to Rs. 24,964,059 of the financial result was observed. The reasons for the deterioration are decrease in bond and guarantee income and increase in wages and salary expenses.

## 3. Operational Review

### 3.1 Uneconomic Transactions

Audit Observation	Management Comment	Recommendation
According to the Corporate objectives of the Fund it was planned to develop a computerized accounting system (QuickBooks) within the organization. Although, an amount of Rs.0.16 million was incurred in the year 2019 to purchase this system. As a result, the Fund is still recording its entire transactions manually	During the year 2019 full accounts and a significant few months of 2020 records were carried through the QuickBook package, but had to be abandoned while operation due to the country's situation	Computerized accounting system should be implemented and the Fund should work to get the maximum benefit from the money spent.

and in spread sheet (Excel) by 31 December 2022. Therefore, the cost of purchasing the system had become an idle of money.

and the difficulty of continuity. The amount spent can be justified due to used the package during 2019 and 2020.

### 3.2 Management Inefficiencies

Audit Observation	Management Comment	Recommendation
<p>(a) The Fund had entered into an agreement with Sri Lanka Telecom during the year 2015 to design and develop a Management Information System (MIS) to the worth of Rs.2.98 million. As per the agreement, the first installment and the second installment to be paid after development total Rs. 2.08 million or 70 percent of the contract value was paid to the relevant institution in the years 2015 and 2016 and it was shown under non-current assets as software development advances in the statement of financial position. Although about 07 years have passed since the money was paid, the preparation of this Management Information System (MIS) was not completed even up to 31 March 2023. However, the completeness of the works under the agreement had not been reviewed and the advance money had not been capitalized or recognized as receivables. Although, the Fund had informed Sri Lanka Telecom to return the money paid. Furthermore, according to Article 20 of the agreement, the Fund had not taken steps to enter into arbitration procedures or to resolve the existing issues through negotiation even during the year.</p>	<p>The contract has been cancelled due to delaying of clients. Although adequate service had been rendered and satisfied for the advance amount given, the entire amount given has been requested to return. Nevertheless, there won't be any financial loss since the organization will still receive the service in the event that the payment is not received. The agreement had already been cancelled and actions had been taken to recover the amount paid. If not, arrangements will be made to go for arbitration.</p>	<p>Amount paid to Sri Lanka Telecom should appropriately recover through negotiation or arbitration.</p>
<p>(b) The Fund was established in 1999 and received a Capital Grant of Rs. 55.00 million from the General Treasury in four instances during the period of 2000 to 2005. But there was no mechanism for remittance of annual profits to the treasury. Meanwhile, from the retained</p>	<p>Since the Fund is a non-profit service organization, there is no balance to make an annual remittance to the treasury. A portion of the guaranteed proceeds is always used to offset the risk and increase</p>	<p>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</p>

earnings of Rs.949.78 million as on 31 December 2020, Rs.500 million was transferred to a reserve account named “Provision for Infrastructure” and remained idle. Retained profits and reserves were Rs.745.85 million, while long-term investments were Rs.1,072.30 million and short-term investments were Rs.1,146.08 million as at 31 December 2022.

the volume/threshold for issuing guarantees.

Under 7(C) of the Trust Deed, the Settlor has empowered the Board of Trustees to take full decisions on operations. Moreover, the allocation has been approved by the Board of Trustees in the budget of those years.

the treasury annually.

(c) During a sample inspection of the southern, central and northern regional offices it was revealed that the head office had not introduced adequate control procedures regarding the expenses of the branches. Accordingly, the total amount of expenses personally spent by the official of those offices in the reviewed year was Rs. 1.08 million and among those expenses electricity bills, water bills and telephone charges, stationery and cartridges were also included. Subsequently, the Fund had reimbursed the officers' expenses. Nevertheless, no maximum limits were introduced and no prior approval had been given for the aforesaid expenses.

The Fund has appointed suitable officers capable of running a regional office. Those officials had been authorized to take appropriate decision when necessary with the approval of the head office. Therefore, the management of the Fund is allowed to obtain low cost goods and low quantity with financial restrictions when necessary. Expenses will be assessed prior to reimbursement.

Proper internal control system should be introduced regarding the expenses of the branches.

#### 4. Accountability and Good Governance

##### 4.1 Tabling of Annual Performance Report in Parliament

Audit Observation	Management Comment	Recommendation
<p>According to 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 the 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, no evidence was presented to the audit regarding tabling annual performance report of the Fund in Parliament even up to the date of this audit report.</p>	<p>The performance report of each year is continually submitted to the Settlor in January of the following year after approval of the Board of Trustees. We strongly believe that the report will be submitted to the Parliament as the Settlor holds the clauses.</p>	<p>Annual performance report of the Fund should be tabled in Parliament in accordance with the provisions of the circular.</p>

## 4.2 Internal Audit

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
Although all activities of the Fund should be subject to internal audit, the Fund had not appointed a qualified auditor to carry out internal audit activities in the Fund since its inception.	The internal audit of the Fund and the immediate audit and survey from time to time are conducted by the Director General of the Treasury (Public Finance) on behalf of the Settlor. Most of the errors are corrected with instructions and keep attention to correct them immediately.	Activities performed by the Fund should be subjected to an independent internal audit and reported to the Board of Trustees periodically.

## 4.3 Budget control

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
According to the Financial Regulation 877 (1) (c) issued by Public Financial Circular No. 01/2020 dated 28 August 2020, the budget prepared by the Board of Trustees for the ensuing year should be remitted to the Director General of National Budget before 30 September of the current year for obtaining the approval thereof. However, the budget of the Fund for the year 2022 had not approved as per the provisions in the above circular.	The proposed budget approved by the Board of Trustees had been continuously sent to the Director General of Finance and the Settlor or the Treasury Secretary of the Ministry of Finance.	Annual budget should be prepared in accordance with the circular and approved by the Treasury.