Central Engineering Consultancy Bureau (CECB) and its Subsidiary - 2012

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1. Financial Statements

1.1 Qualified Opinions

(a) Qualified Opinion–CECB

In my opinion, except for the effects of the matters described in paragraph 1.3 of this report, the financial statements give a true and fair view of the financial position of the Central Engineering Consultancy Bureau as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(b) Qualified Opinion –Group

In my opinion, except for the effects of the matters described in paragraphs 1.2 and 1.3 of this report, the consolidated financial statements give a true and fair view of the financial position of the Central Engineering Consultancy Bureau and its Subsidiary as at 31 December 2012 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Group Financial Statements

The following observations are made.

(a) The audited financial statements of the Central Engineering Services Limited (CESL) which is the fully owned Subsidiary of the CECB had been taken for prepare the Consolidated financial statements.

(b) The operational income of the Subsidiary had been mainly generated from the construction contracts which sub contracted by the CECB retaining a profit margin around 10 per cent. However, the intercompany transactions had not been recorded in the books of accounts of the CECB as well as the Subsidiary. As a result, the year end balances relating to these transactions such as debtors, creditors, retention moneys receivable and payable, mobilization advances receivable and payable etc. had not been appeared in the financial statements of the both Institutions.

(c) The Current Account balance shown in financial statements of the CECB and the Subsidiary had not been reconciled and as such a difference of Rs.159,579,941was observed between those two financial statements. Further, intercompany current account debit balance of Rs.97,646,808 had been deducted from the current liabilities in the financial statements of the CECB and as a result, both current liabilities and current assets shown in that financial statements had been understated by similar amount.

(d) The CECB had eliminated 3.9 Billion revenue of the CESL (subsidiary) in consolidation of the financial statements as intercompany transactions. However the CECB had accounted the transaction with the CESL as cash basis while the CESL accounted it's transaction with the CECB on accrual basis. Hence eliminating of the intercompany revenue as stated above without details analysis, the group gross profit would be inaccurate.

Further, the entire profit margin of the road projects undertaken by the CECB had been accounted under its revenue without being removed the profit margin included when sub-contracting those to the CESL. Hence, the revenue of the CECB and the cost of the sales of the group as at 31 December 2012 had been overstated and understated by Rs 65,231,252.

1.3 Financial statements of the Central Engineering Consultancy Bureau

1.3.1 Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) **LKAS 11 – Construction Contract.**

The following observations are made.

(i) As per paragraph No. 8 of the Standard, when a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract. The Bureau had been identified the number of construction contracts as a single contract even though the separate proposals have been submitted for each contract and there was a possibility to identify the cost and revenue of each asset separately.

(ii) The general overhead expenditure relating to the Base Offices specially established for carrying out the main operational activities of the Bureau in the respective areas had not been apportioned among the construction contracts handled during the year and as a result, the profit or loss of each contract had not been accurately reflected in the financial statements. For instance, the general overhead which had not been apportioned among the construction contracts handled by Badulla Base Office for the year 2012 was Rs.54, 943,793.

(iii) The cost of contract and revenue should be taken to ascertain the profit or loss of each contract for the accounting period in which the work is performed by using the percentage of completion contract method. Instead of being followed that method, the CECB had transferred the cost and revenue of the contracts to the statement of comprehensive income. Due to that lapse the profitability of the individual contract could not be ascertained and the other expenditure charged to each contract also could not be filtered from the present computer system.

(iv) According to Paragraph 36 of the Standard, any expected contract cost over total contract revenue should be recognized as an expense immediately. However, no such early recognition of expected contract losses were observed. Therefore, the possibility for material impact to the income statements due to recognizing the contract loss at the time of completion of the contract could not be ruled out in audit. For instance, contract loss of Rs.35,715,576 relating to 05 Projects carried out by the Badulla Base Office were recognized at the time of completion.

(b) **<u>LKAS 24 – Related Parties and Related Party Transactions</u>**

(i) The following transactions and involvements with the Subsidiary had not been disclosed in the financial statements.

- Payment of Rs.65 million as an advance for purchase of vehicles.
- Value of material issued for the Projects handled by the Subsidiary.
- Acting the Chairman of the CECB as a Managing Director of the Subsidiary.
- Involvement of the management of the CECB in the operational activities of the Subsidiary. (eg. The Additional General Managers of the Base Offices of the CECB functioned as the Operational Managers of the Base Offices of the Subsidiary).

(ii) The following items relating to intercompany transaction either had been disclosed in properly or not disclosed in both financial statements. Hence, the accuracy of those transactions and their impact to the financial statements could not be ensured in audit. Details are shown below.

Item	Amount As per the Financial Statements of the CECB Rs.	Amount as per the Financial Statements of the Subsidiary Rs.
Material Purchase	252,577,976	213,380,944
Fund Transfers	108,624,689	-
Vehicle Maintaining Income	658,474	-

1.3.2 Accounting Policies

The following observations are made.

(a) Differed tax assets/liabilities had not been ascertained and accounted for. Therefore, the accounting policy disclosed relating to differed tax had been actually not in practice.

(b) The nature, purpose etc. in respect of capital reserved amounting to Rs.12,697,551carried forwarded in the financial statements year by year had not been disclosed.

1.3.3 Accounting Deficiencies

The following observations are made.

- Whatever cash received from a client (Eg. mobilization advance, contract payment, retention money) for a particular contract had been credited to the debtor account without being posted them to the relevant individual accounts. In addition to that, in most instances the value of invoices/certified bills relating to the contract had not been posted to the respective debtor account which resulted to reflect credit balances therein at the year end. The credit balance of such debtors shown in the financial statements as at 31 December 2012 was Rs.756, 638,966.

- The following observations are made with regard to the impairment assessment of trade and other receivables as at 31 December 2012 based on the first time adoption of SLFRS.

    - The trade debtors relating to few Base Offices such as Uva, Central, North Central and Western Province whose outstanding period exceeded five years as at 31 December 2012 had only been taken for the impairment assessment without being considered other Base Offices. Therefore, the completeness of the

impairment assessment made as at 31 December 2012 could not be ascertained in audit.
Further, the calculation of impairment on debtors solely based on the period of outstanding would not be provided a proper base for its fair valuation.

- Impairment of other receivables such as retention, advances, and prepayment etc. had not been ascertained.

- The impairment of trade debtors had been done without derecognizing the provision for bad and doubtful debtors which had already been made in the previous financial statements and as a result, the trade debtors shown in the financial statements had been understated by Rs.71,967,669.

(c) In the examination of the Uva paranagama Road Project as a sample test of the six road projects awarded to the CECB by the Ministry of Economic Development, it was revealed that the contract value of the Project was Rs.411 million and the major portion of that had been sub-contracted to the Subsidiary for Rs.313 million. The following observations are made in this regard.

- According to the invoices furnished to the Bureau, the total value of the work done by the Subsidiary as at 31 December 2012, was Rs.78,721,128. However, according to the financial statements of the CECB, the contract expenditure of the Subsidiary was Rs.37,946,427. Hence, the construction cost shown in the financial statements of the Bureau as at 31 December 2012 had been understated by Rs.40,774,701.

- The retention money of Rs.7.8 million payable to the sub-contractor had not been accounted in the financial statements of the CECB.

(d) The general suspense account having credit and debit balances in respect of the Central Province and Supported Services amounting to Rs.420,160 and Rs.1,573,124 respectively, which had been carried forwarded year by year in the financial statements over a longer period, had been cleared in 2012 transferring them to the miscellaneous income and administration cost respectively, without being investigated.

(e) Head Office expenditure reimbursed by the Base Offices amounting to Rs.103,730,202 had been inappropriately shown as other income and expenditure in the financial statements of the CECB and the Group respectively.

(f) The machineries and equipment received from the Government as a grant for expedite the Road Projects in 2012 had not been valued and brought to the financial statements.

(g) The Bureau had not considered the amounts in payment certificates / certified bills in ascertaining the yearend accounts balances in relating to the Projects carried out in each accounting year and as a result, the real position of the transaction of those Projects had not been reflected in the financial statements.

The following observations are also made in this regard.

(i) The debtor balances shown in the financial statements in respect of Jawatta Base Office and Consultancy Division had been overstated by a net amount of Rs.17,798,552.

(ii) The mobilization advance balances of Ampara and Monaragala Base Offices shown in the financial statements as at 31 December 2012 had been overstated by Rs.42,770,381.

(h) Charges and recoveries in relation to the Projects handled by the Monaragala Base Office had not been taken into account in ascertaining the debtor balance of the contactors as at 31 December 2012 and as a result, the debtors shown in the financial statements of the year under review had been overstated by Rs.117,776,983.

(i) According to the valuation report furnished to audit the land, buildings and motor vehicles belonging to the selected Base Offices only had been revalued without being covered the entire assets of the organization, as such the revaluation made on those assets could not be accepted in audit.

1.3.4 Accounts Receivable and Payable

The debtor balance remained outstanding for more than one year as at 31 December 2012 was Rs.1,780,104,171 and proper recovery actions had not been taken in this regard.

1.3.5 Lack of Evidence for Audit

The following observations are made.

(a) Property, Plant and Equipment valued at Rs.8,448,412 had been written-off in the year 2012. However, the Board of Survey reports and required approval for written-off were not made available for audit to verify the accuracy and validity of the adjustments made in the financial statements.

(b) Project wise analysis of the closing stock balance of Rs.20 million of the University of Uva Wellassa main projects was not made available for audit and as such, the accuracy of the cost and stock balances of the individual projects was not ensured in audit.

1.3.6 Unreconciled Control Accounts

Inter Base Office Current Account balances had not been reconciled and net difference of Rs.6,701,059 had been shown in the financial statements under current liabilities.

1.4 Non-compliances with Laws, Rules, Regulations and Management Decisions etc.

The following non-compliances were observed.

Reference to Laws, Rules, etc.	Non-compliance
(a) Public Enterprises Circular No. PED/12 of 02 June 2003	
(i) Paragraph 7.4.2	Although the Senior Management Committee (SMC) should be met at least five days prior to the Board Meeting and the Board should apprise the decisions taken at the SMC meetings, it was noted that the most of the instances the SMC had not met prior to the Board meetings and evidence to confirm whether the Board had apprised the decisions taken at the SMC meetings held during the year under review was not made available to audit.
(ii)Paragraph 8.8	Approval of the Board should be obtained for the delegation of financial authority, indicating limits of expenditure and no expenditure should be authorized, incurred or paid outside the limits of such delegated authority. Further such delegation of authority should be updated and approved by the Board at the beginning of each year. But no such procedure had been followed by the Bureau during the year under review.
(b) National Procurement Guideline 2006	
• Guideline 2.8	Technical Evaluation Committee (TEC) meetings had been held in 2012 without a subject specialist.
(ii) Guideline 5.4.12	The details of Value Added Tax paid amounting to Rs.351,064,820during the year under review had not been informed to the Commissioner General of Inland Revenue with a copy to Auditor General on or before the 15 days of the following month as requested.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the operations of the CECB for the year under review had resulted a pre-tax net profit of Rs.544. 89 million as compared with the corresponding pre-tax net profit of Rs.308.03million for the preceding year, thus indicating an improvement of Rs.236.86million or 43.4 per cent in the financial results.

The operations of the Subsidiary of the CECB during the year under review had resulted in a pre-tax net profit of Rs.13.81million as compared with the corresponding pre-tax net profit of Rs4.09 million in the preceding year thus indicating an increase of Rs9.72 million in the financial results.

The increase of income by Rs.4,554 million and expenditure by Rs.4,305 million during the year under review were the main reasons for the these improvements.

2.2 Analytical Financial Reviews

The following observation is made.

The CECB had earned a pre-tax net profit of Rs.544 million during the year under review by utilizing its staff strength of consisting 1,416 employees and total assets base of Rs.3,097 million. Thus the profit represented 17 per cent of the total assets of the Bureau.

2.3 Performance Review

The following observations are made.

(a) The CECB Consultancy Division had been fully equipped with all necessary physical and human resources to serve the Nation in all types of engineering consultancies. However, at present CECB had mainly focused on construction works rather than consultancy in contrary to the objectives of establishing the Bureau.

(b) Out of the operating revenue of the Bureau for the year 2012, only 11 per cent had been earned from providing consultancy services and the rest of the revenue had been earned from construction work. Even though, there are number of state owned institutions to undertake construction works such as State Development and Construction Corporation, State Engineering Corporation, Building Department etc. the consultancy works are undertaken only by the CECB and SEC. Nevertheless, CECB had not strategically focused on engineering consultancy which has been the mandated task assigned at the inception of the Bureau, because the business turnover and the volume of work seems to be higher in construction works. Therefore, CECB need to be more focused on engineering consultancy works by maximum utilization of experts in this field in order to become a truly world class Sri Lankan engineering organization.

3. Operating Review

3.1 Management Inefficiencies

The following observation is made.

Ministry of Economic Development had recovered a sum of Rs.252 million from the CECB for supplying bitumen and usage of their machineries for the sub contracted jobs undertaken by CESL. However, quantity reconciliations of the bitumen barrels received and utilized for the construction works had neither been done by the CECB nor CESL. Hence, fair usage of bitumen for the construction works was not ensured in the audit.

3.2 Transactions of Contentious Nature

The following observations are made.

(a) Various allowances had been paid to the permanent and contracted employees of the Bureau with the approval of the Board of Directors in contrary to the Public Enterprises Department Circular No 95 of 04 June 1994.

(b) Out of 80 per cent of the Road Projects, undertaken by the CECB had been sub-contracted to the CESL without allowing them to get contracts through competitive bidding, which is the main purpose in establishment of this Company.

It was further observed that the above works had been carried out by the Company using human, physical and other resources belonging to the CECB on free of charge. For instant, preparation of BOQs, estimate and invoices for both organizations are done by the same personnel of the CECB.

(c) According to the information furnished relating to the Project No D 1474, the completion of 50 per cent of the work by incurring only 7 per cent of the estimated project cost of Rs.246,228,000is opened to question. Hence, the accuracy of the recognized cost, revenue and the balance of the due to/due from customer account were not ensured in audit.

3.3 Uneconomic Transactions

Two Road Projects had been undertaken by the Ampara and Monaragala Base Offices under the Deyata Kirula Program in 2012. As the Projects had been abounded after implement of certain activities, the recoverability of the cost incurred amounting to Rs.7,923,500 and Rs.752,273 respectively were in doubt.

3.4 Identified Losses

Loss of Rs.277,807,649had been incurred by the Bureau during the year under review in respect of 61 construction contract undertaken due to improper accounting systems and poor contract administration.

3.5 Human Resources Management

The approved and actual cadre of the Bureau as at 31December 2012 was 1,132 and 1,416 respectively. As actual staff strength of all employee categories had been exceeded, a proper personal management was not observed at all.

4. Budgetary Control

Significant variances were observed between the budget and the actuals thus indicating that the budget had not been used as an effective instrument of management control.

5. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Bureau by my detailed report issued in terms of Section 13(7)(a) of the Finance Act. Special attention is needed in respect of the following areas of control.

- Asset Management
- Inventory Control and Stock Management
- Procurement
- Accounting and Financial Management
- Invoicing
- Fund Management
- Debtors and Receivables
- Creditors, Advances and Payables
- Performance Evaluation
- Contract Administration
- Investment and Control over Subsidiary
- Human Resource Management