

National Engineering Research and Development Centre of Sri Lanka -2013

The audit of financial statements of the National Engineering Research and Development Centre of Sri Lanka comprising the statement of financial position as at 31 December 2013 and the statement of financial performance, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes 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 Section 13(1) of the Finance Act, No. 38 of 1971 and Sub-section 1 of Section 2 of the State Industrial Corporations Act, No. 49 of 1957 and the Gazette Extraordinary No.124/6 of 14 August 1974. My comments and observations which I consider should be published with the Annual Report of the Centre in terms of Section 14(2)(c) of the Finance Act appear in this report

1:2 Management’s Responsibility for Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements whether due to fraud or error.

1:3 Auditor’s Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards, consistent with International Standards of Supreme Audit Institutions (ISSAI 1000-1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Centre’s preparation and fair presentation of the financial statements 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 Centre’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2. Financial statements

2:1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the National Engineering Research and Development Centre of Sri Lanka as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

2:2 Comments on Financial Statements

2:2:1 Accounting Deficiencies

The following observations are made.

- (a) The test reports on 70 samples of electric lamps received by the Centre during the period from the year 2009 to the year 2011 had been issued without recovering the test fees. The test fees amounting to Rs.633,288 receivable in this connection by the Centre had not been brought to account as the income and the test fees receivable (debtors) of the respective years.
- (b) The museum pieces valued at Rs.1,765,179 had been brought to account in the year under review as property, plant and equipment. As such the museum pieces had been understated and the property, plant and equipment had been overstated by that amount.
- (c) Even though the amortization relating to the capital grants amounted to Rs.60,585,395, that had been brought to account as Rs.60,354,983. As such the loss for the year under review had been overstated by a sum of Rs.230,412.

2:2:2 Accounts Receivable and Payable

The following observations are made.

- (a) The debtors balance of Rs.17,000,942 comprising 21 trade and other debtors accounts as at 31 December 2013 included debtors balances amounting to Rs.49,542 between one year and 3 years old and debtors balances amounting to Rs.1,229,722 older than 8 years.
- (b) The trade creditors balances totalling Rs.2,842,276 included unsettled balance of Rs.252,160 older than 5 years and Rs.198,812 not settled for more than 02 years.

2:2:3 Transactions not supported by Adequate Authority

An Incentive Scheme for the payment of incentives from the profits of commercial projects with effect from the year 2012 had been introduced in accordance with the decisions of the Board of Directors dated 22 May 2012 and 22 May 2013 and the approval of the Department of Management Services had not been obtained for that. A sum of Rs.5,029,560 out of the

commercial projects profits of the year under review and a sum of Rs.3,340,442 from the preceding year had been spent on the incentives. The amount spent on the incentives in the year under review as compared with the preceding year, had increased by 50 per cent and the Chairman informed the audit that it was due to the profits earned by most of the projects.

2:3 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following non-compliances were observed.

Reference to Laws, Rules, Regulations	Non-compliance
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(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka.	
Financial Regulation 104, 105, 106 and 110	Action in terms of the Financial Regulations had not been taken in connection with damage totalling Rs.239,694 caused to 04 motor vehicles in the preceding year, damage totalling Rs.138,422 caused to 03 motor vehicles in the year under review by accidents and the damage caused by fire amounting to Rs. 277,095 to the assets of the Centre at the “Sahasak Wmeasum” Exhibition held at the Bandaranaike Memorial International Conference Hall.
(b) Section II of the Finance Act, No. 38 of 1971, the Public Enterprises Circular No. PED/25 of 29 June 2004 and the Public Finance Circular No. PF/PE/9 of 27 June 2006.	A sum of Rs.207,000 in fixed deposits and a sum of Rs.66,934,804 in seven day's call deposits in a State Bank had been invested without the approval of the Minister of Finance and the appropriate Minister.
(b) Public Enterprises Circular No. PED/40 of 27 September 2006.	Even though the Public Administration Circulars issued to Government Ministers and Departments cannot be made applicable to Public Corporations and Boards, according to the decisions of the Board of Directors dated 25 September 2013 based on the Public Administration Circular No. 28/2011 of 11 December 2011, the monthly allowance of Rs.15,000 paid to the Sri Lanka Engineering Service, amounting to Rs.600,000 had been paid by the Centre to 40 Engineers. Even though the profits of the Commercial Projects had been utilized for the payment of the allowance for the year 2013, the approval of the Treasury for that had not been obtained while provision for that had not been made in the budget.

- (d) Public Finance Circular No. 438(2) of 13 November 2009 and Financial Regulations 756, 757 and 771.
- (i) Disposable stocks valued at Rs.1,104,447 had not been disposed of.
- (ii) Even though goods/assets should be physically verified and a completed report including the balance according to the Inventory Register, Physical balance excesses, shortages, etc. should be furnished, the report furnished in connection with fixed assets valued at Rs.427,191,173 had been included only to shortages of goods and damaged goods.

3. Financial Review

3:1 Financial Results

According to the financial statements presented, the operations of the Centre for the year ended 31 December 2013 had resulted in a deficit of Rs.29,621,795 as compared with the corresponding deficit of Rs.24,846,134 for the preceding year. As such, the deterioration of the financial results of the year under review by a sum of Rs.4,775,661 had been mainly due to the increase of the administrative expenditure by a sum of Rs.28,231,334.

4. Operating Review

4:1 Performance

The following observations are made.

- (a) According to the information furnished by the Centre, the information on the Research Projects of the Centre for the 05 years from 2009 to 2013 is given below.

Particulars	Years					Total
	2013	2012	2011	2010	2009	
Researches commenced	08	18	16	14	09	65
Researches completed	--	13	15	11	07	46
Researches abandoned	--	01	--	02	06	09
Unsuccessful Researches	--	01	02	02	01	06
Technology on Researches transferred	--	--	01	--	--	01
Researches used	--	06	06	03	01	16

- (b) Even though the Research Project activities of 15 Researches commenced during the years 2009 to 2013 by utilizing Treasury provisions amounting to Rs.7,019,692 had been finalized, the final reports had not been issued up to date.

4:2 Management Inefficiencies

The following observations are made.

- (a) The Project commenced in the year 2004 with the objective of the generation of electricity by the implementation of an electricity generation system had been abandoned in the year under review due to the inability to achieve the objective. As such the assets purchased and constructed at a cost of Rs.4,740,000 and electricity generators valued at US\$ 86,250 had been idling. The other costs incurred on the Project amounted to Rs.34,165,937 and out of that a sum of Rs.32,913,445 had been spent on repairs to the electricity generator.
- (b) Action had not been taken even in the year under review for the recovery of the Value Added Tax amounting to Rs.29,985,277 and the Withholding Tax amounting to Rs.239,092 recoverable in respect of the period 2005 to 2013 from the Department of Inland Revenue.
- (c) Due to the decrease of the works orders received by the Commercial Project on testing of batteries in the years 2012 and 2013 as compared with the year 2011 as a result of the delays in the issue of test reports, the project income had decreased. In view of the decrease in the testing of batteries, the machinery and equipment valued at Rs.17,773,523 purchased by the Centre in the preceding years for testing of imported batteries had been underutilized.
- (d) Due to the delays in the issue of performance reports on 698 orders for receipts amounting to Rs.7,886,566 relating to the testing of imported electric lamps during the years 2009 to 2012, the income of that project had decreased rapidly in the preceding years. Accordingly, the net income of the years 2012 and 2013 as compared with the year 2011 had decreased by 51 per cent and 83 per cent respectively.
- (e) A sum of Rs.63,518,112 had been held during the period 2002 to 2013 in seven day call deposits at low rates of interest. The management had not taken action to invest the money in deposits which yield higher rates of interest.
- (f) A sum of Rs.203,850 had been spent in the year 2011 for the implementation of the ISO-9001 Systems Certification in the Centre from that year. Even though a period of 03 years had elapsed since then, action had not been taken to obtain the Systems Certification.

4:3 Operating Inefficiencies

The following observations are made.

- (a) The Centre had placed an order on 27 August 2013 for the purchase of a dust sampling machine for Rs.2,313,584 from a private firm. Even though the machine should have been supplied on 26 November 2013, the supply had not been completed even by the end of February 2014.

- (b) Even though the construction of a sewerage systems project for the Negombo Municipal Council at a cost of Rs.10,984,594 had been commenced in the year 2002, the Municipal Council had not taken over the project as the project was not functioning properly. Action had not been taken for the recovery of the sum of Rs.2,128,636 receivable as at 31 December 2013.
- (c) The advances amounting to Rs.4,649,870 received by the Centre from the clients for various projects, included a sum of Rs.1,642,500 obtained from a Government institution in the year 2010 for testing of electric lamps. As the test had not been carried out up to date, that remained without being settled over 04 years. As two projects of Rs.15,000 had not been implemented that amount further remained in the Advance Account.
- (d) Shutter sets hired out to 09 clients during the period 2003 to 2005 had not been handed over to the Centre even by 31 December 2013. Action had not been taken even by the end of the year under review to settle the deposits amounting to Rs.105,500 obtained from the clients by recovering the shutter sets.
- (e) Even though earning an income of Rs.3,000,000 had been planned in the year under review from the supply of consultancy services for construction of buildings and the project commenced with the objective of introducing the low cost constructions by using the technology of the Centre to the State Sector, it had not been possible to achieve the expected targets.

4:4 Idle and Underutilized Assets

The following observations are made.

- (a) Ten items of machinery and equipment valued at Rs.47,606,810 purchased for each of the Divisions of the Centre had been idle or underutilized during periods ranging from one year to 07 years.
- (b) Sixty four items of stocks valued at Rs.2,357,210 in the main stores of the Centre had been idling over periods exceeding 13 years.
- (c) A hydraulics free stressing machine invented by the Technology and Livestocks Division at a cost of Rs.770,792 had been underutilized over a period of 04 years.

4:5 Uneconomic Transactions

A sum of Rs.1,968,270 had been paid in the year under review to a foreign examiner to visit and examine the CNC Milling machine that remained out of order for over two years in the design and Consultancy Services Division. Even though repairs had been done in three instances it had not been able to operate the machine even by the end of the year under review.

4:6 Identified Losses

The Centre had incurred a loss of Rs.205,326 from Three Commercial Projects completed during the year under review.

4:7 Deficiencies in the Contract Administration

Even though the construction work on the Nurses Quarters Building of the Polonnaruwa General Hospital had been commenced on 17 June 2011 on a revised estimate of Rs.24,293,400, the approval of the Technical Evaluation Committee had not been received even by March 2014. The following observations are made in this connection.

- (a) Even though a period of 03 years had elapsed after the award of the contract, an agreement in terms of Guideline 33.6 of the Institute of Construction Training and Development (ICTAD) and Section 8.9 of the Procurement Guideline, had not been entered into up to date.
- (b) A sum of Rs.9,176,421 receivable by the Centre for the bills furnished to the Ministry of Health had not been recovered even by 20 February 2014, the date of audit.
- (c) Even though the value of extra work amounted to Rs.2,984,169, the approval for extra work in terms of the provisions in the Procurement Guide lines had not been obtained.
- (d) Even though the contract should have been commenced on 15 April 2011 and completed in 04 months, it had been completed on 22 February 2013. The receipt of a sum of Rs.2,047,560 receivable as price variance due to the delays in the construction was observed in audit as doubtful.

4:8 Delayed Projects

The following observations are made.

- (a) Even though the project on the manufacture of an equipment for the production of forage pellets for milk cows had been scheduled for commencement on 01 July 2006 and completion on 30 September 2006, the completion of the project had been delayed up to the year 2008. The total cost incurred on the project amounted to Rs.2,144,290 and it was observed that it had not been able to operate the machine for the achievement of the expected results even by the end of the year under review. The loan balance receivable for the machine from the year 2009 amounted to Rs.371,152.
- (b) A Memorandum of Understanding had been entered into with the University of Moratuwa on 01 June 2012 for the implementation of the Demining Robot Project and a sum of Rs.1,085,662 had been paid to the University of Moratuwa on 20 August 2012 and 11 January 2013. Even though the project had been scheduled for commencement in June 2012 and completion in July 2013, the Project had not been completed. Any progress of the Project was not observed in audit.

4:9 Abandoned Projects

As 19 researches costing Rs.3,066,060 had been abandoned during the period 2009 to 2013, it was observed in audit that the expenditure incurred on those projects as uneconomic transactions.

4:10 Non-achievement of Expected Results from Project/ Failed Projects

Even though a sum of Rs.55,316,080 had been written off from the accounts as the annual research expenses of 16 projects, the expected results of the researches had not been achieved. It was also observed that the machinery purchased and manufactured for these projects had been idling.

4:11 Personnel Administration

The information on the approved and the actual number and the vacancies and excess in the personnel of the Centre is given below.

Post -----	Approved -----	Actual -----	Vacancies -----	Excess -----
Executive Grade	79	51	28	--
Non-Executive Grade	229	223	42	19

Four officers who did not have experience of one year in the relevant field had been recruited on contract basis outside the procedure approved on 31 January 2013 by the Department of Management Services for recruitment of personnel to the posts of Management Assistant non-technical (Test Services) and monthly allowances amounting to Rs.170,626 had been paid from June to December 2013 instead of salaries.

5. Accountability and Good Governance

5:1 Budgetary Control

Significant variances between the estimated expenditure of the year under review and the actual expenditure ranging from 11 per cent to 43 per cent were observed, thus indicating that the budget had not been made use of as an effective instrument financial control.

6. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Centre from time to time. Special attention is needed in respect of the following areas of control.

- (a) Costing and Management of Projects
- (b) Construction Projects Management
- (c) Debtors
- (d) Utilization of Machinery
- (e) Motor Vehicles Control