
State Engineering Corporation of Sri Lanka - 2013

The audit of financial statements of the State Engineering Corporation of Sri Lanka for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the comprehensive income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, 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 Section 29 (2) of the State Industrial Corporations Act, No.49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2)(c) of the Finance Act appear in this report.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka 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 judgment, 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 Corporation'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 Corporation'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.

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Engineering Corporation 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 Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Accounting Policies

The following observations are made.

(a) Even though it was stated that the expenditure of capital nature incurred on projects but uncompleted during the year had been identified as an uncompleted capital balance in terms of the **Accounting Policy No.3.2.2**, the C-city Building on which an expenditure of Rs.212.25 million had been incurred with 20 per cent progress of completed work as at the end of the year under review had been brought to account as property, plant and equipment.

(b) Even though it was stated that the possibility of recovering loans from each debtor would be evaluated separately and the amount of impairment be decided for trade and other debtors in terms of the **Accounting Policy No.3.3.1.9,** contrary to that, a General Provision on Bad Debts amounting to Rs.500.68 million had been made for the entire debtors.

(c) Even though it was stated that the valuation of stocks in terms of the **Accounting Policy No.3.2.4** is done at cost or the net realizable value whichever is less, in the valuation of finished stocks and raw material stocks as at 31 December 2013, the Corporation had valued the stocks based only on the cost without computing the net realizable value.

2.2.2 Accounting Deficiencies

The following accounting deficiencies were observed.

(a) The debtors balance as at the end of the year under review had been understated by Rs.496,541,127 as a result of an unusual credit balance of Rs. 496,541,127 in the debtors balance as at that date.

(b) Even though the balances of the Inter-Departmental Current Accounts of the various Divisions of the Corporation should be adjusted against each other at the end of the year, those had not been correctly reconciled and as such a debit balance of the Inter-Departmental Current Account amounting to Rs.96,088,486 had been shown in the financial statements as at the end of the year under review.

(c) Lands, 799 perches in extent owned by the National Housing Development Authority and not vested with the Corporation had been valued at Rs.79,615,000 and brought to account. It was further observed that these lands had been shown as an asset in the financial statements of the National Housing Development Authority as well.

(d) Even though receipts of Government Grants amounting to Rs.702.31 million at the end of the year under review should be shown under equity in the financial statements, out of that value, a sum of Rs.555.18 million had been shown under non-current liabilities and the remaining Rs.147.13 million had been shown under current liabilities.

(e) Unusual debit balances of Rs.393.03 in the Liability Accounts and unusual credit balances of Rs.67.74 million in the Assets Accounts of the Corporation as at the end of the year under review as well were observed. Thus the current liabilities and the current assets as at 31 December 2013 had been understated by those amounts respectively.

(f) A sum of Rs.17.63 million spent in the year under review for publicity and other expenses of the C-City Project had been brought to account as publicity and promotion expenses of the Corporation instead of showing as an expenditure of that Project.

(g) The written down value of fixed assets amounting to Rs.278.68 million had not been considered in the computation of Deferred Tax in the year 2012. As such the error of overstating the Deferred Tax Assets Account by Rs.33.44 million had not been rectified retrospectively in the year under review. Thus the profit of the previous year had been overstated by Rs.33.44 million and the profit of the year under review had been understated by the same amount.

(h) Expenditure amounting to Rs.21.26 million paid in the year 2012 and included in a Sub-contract Expenditure Control Account had been computed as a current asset instead of being transferred to the income statement of that year and it had not been settled even in the year under review. As such the retained income as at 31 December 2013 had been understated by that same amount.

(i) Despite being informed that Value Added Tax amounting to Rs.168.99 million recoverable from the Sri Lanka Cricket by the Corporation for a service supplied in the year 2010 could not be paid as the Sri Lanka Cricket is exempted from Value Added Tax, no action had been taken to obtain reimbursement of that amount from the Department of Inland Revenue or for making a provision for that.

(j) The debit balance in the Nation Building Tax Account amounting to Rs.13.54 million shown in the financial statements as a balance recoverable from the year 2011 due to an error in accounting and remained so without being adjusted even by the end of the year under review.

2.2.3 Unusual Adjustments made in the Financial Statements

Machinery, plant and motor vehicles with a carrying amount of Rs.100.60 million as at 31 December 2012 had been revalued at Rs.477.10 million as at that date and those assets had been revalued once again at Rs.240.70 million on 01 January 2013.

2.2.4 Unexplained Differences and Unreconciled Control Accounts

Balances of 09 accounts shown in the financial statements had not been reconciled with the balances shown in the schedules related thereto and a difference of Rs.732.23 million was observed between the two balances.

2.2.5 Lack of Evidence for Audit

The documentary evidence indicated against each of the following items of account valued at Rs.242.82 million had not been furnished to audit.

	Item of Account	Value Rs. Millions	Evidence not made Available
(a)	Capital receipt from shifting the Precast Yard from Narahenpita to another place.	22.65	Files containing the source of receipt and Registers of Transfers
(b)	Balance of the Account No.9934 containing cash and cash equivalents.	1.88	Bank Statements, Bank Reconciliation Statements and Confirmation of Balances
(c)	Cash balances of the Sri Lanka State Engineering Corporation (Qatar) Ltd.	5.95	Bank Confirmations, Bank Statements, Bank Reconciliation Statements, Credit Advice Notes
(d)	Retention Money (Machinery Division)	19.77	Schedules, Age Analyses
(e)	Mobilization Advances – Machinery Division	20.33	---do---
(f)	Temporary difference for Deferred Tax (Property, plant and equipment)	172.24	Schedules, Computations
		242.82	

2.2.6 **Accounts Receivable and Payable**

(a) Out of the balance of trade debtors as at the end of the year under review amounting to Rs.4,655.6 million, over 95 per cent remained receivable from Government Institutions. Out of that, a sum of Rs.1,959.8 million represented balances older than 03 years.

(b) A sum of Rs.1,133.82 million receivable from the Sri Lanka Cricket since the year 2011 for 04 projects had not been recovered even up to 31 December 2014. According to the financial statements of the Sri Lanka Cricket as at 31 December 2013, the value payable to the Corporation for the aforesaid projects amounted to Rs.568.62 million. As such, a difference of Rs.565.20 million was observed between the amount receivable and the amount payable.

(c) Even though a sum of Rs.20.56 million payable to the Urban Development Authority and a sum of Rs.5.36 million recoverable from the Urban Development Authority had been brought forward continuously by the Corporation since the year 2000, no effective action whatsoever had been taken for the payment or the recovery of those amounts.

(d) Even though the amount of Rs.805,938 recoverable from the cashier of the Seruwila work site in respect of the cash fraud committed by him had been shown in the accounts from the year 2008 up to date, no proper action had been taken to recover it even by the end of the year under review.

(e) Mobilization advances amounting to Rs.1,088 million obtained in the year 2010 and previous years had remained unchanged even by the end of the year under review.

(f) Out of the sum of Rs.125.46 million allocated for Accrued Expenses of the Consultancy Division by the end of the year 2012, the balance unsettled even by the end of the year under review amounted to Rs.124.89 million.

(g) The sum of Rs.637.27 million shown as Tax Payable from the year 2011 had not been settled even by the end of the year under review.

(h) The balance of Rs.9.61 million payable since the year 2011 to the sub- contractors of 58 work sites had not been settled even by the end of the year under review.

(i) Action had not been taken to submit invoices and recover the money even by the end of the year under review for 18 projects of the Constructions Division for which an accumulated cost of Rs.131.8 million had been incurred since the year 2010.

2.3 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following non-compliances were observed.

Reference to Laws, Rules and Regulations and Management Decisions	Non-compliance
(a) Section 14(1) of the Finance Act, No.38 of 1971	The Corporation had not presented a draft of the Annual Report along with the annual financial statements to the Auditor General.
(b) Financial Regulations of the Democratic Socialist Republic of Sri Lanka	
(i) Financial Regulation 134 (3)	Copies of internal audit reports had not been forwarded to the Auditor General.
(ii) Financial Regulation 396	Action had not been taken in terms of the Financial Regulation in respect of 19 cheques to the value of Rs.12,666,531 expired over 6 months after issuing.
(c) Public Enterprises Circular No. PED/PEN/2011/01 of 11 February 2011	
• Paragraph No.01	Advertising and Promotion Expenses amounting to Rs.21.36 million had been incurred by the Corporation in the year under review contrary to its objectives.
• Paragraph No.02	The Corporation did not have an annual advertising programme approved by the Board of Directors for the year under review.
(d)Management Services Circular No.01/2013(i) of 09 December 2013	The bonus for the employees of the Corporation had been overpaid by Rs.15,950,500 contrary to the provisions of the Circular.
(e)Section 1 of the Management Services Circular No.39 of 26 May 2009	A payment of Rs.158.67 million had been made as allowances for employees holding posts in the service categories such as Engineer, Architect and Quantity Surveyor for the year under review without the approval of the Department of Management Services and the recommendation of the Salaries and Cadre Commission.

(f) (i) Paragraph 4.2.1 of the Procurement Agency Circular No.08 of 25 January 2006	The Corporation had not prepared a Procurement Plan for the year under review.
(g) Management Services Circular No.28 (II) of 01 August 2006 and the Letter of the Director General of the Department of Management Services No. DMS/E3/43/4/265/1 of 25 November 2009	Despite having been informed that creating posts or filling vacancies should not be done without the approval of the Department of Management Services, 32 posts had been created and 197 employees had been recruited for those posts.
(h) Letter No. DMS/E3/43/4/265/1 of 14 February 2011 of the Department of Management Services	Even though the approved, permanent and untrained number of employees for the year under review was 460, the actual cadre employed as at 31 December in the year under review was 706.
(i) Letter No. BD/356/303/23 N of 28 April 2004 of the Department of National Budget	The cash balance of Rs.20,278,812 remained after paying compensation from the money granted by the General Treasury under the Scheme of Voluntary Retirement had not been returned even up to 31 December of the year under review.

3. Financial and Operating Review

3.1 Financial Results

The operations of the Corporation during the year under review had resulted in a pre-tax net profit of Rs.148.57 million as compared with the corresponding pre-tax net profit of Rs.225.91 million for the preceding year, thus indicating a deterioration of Rs.77.34 million in the net profit as compared with the preceding year.

The deterioration of the operating profits of the Special Operations Division and the Consultancy Division had indicated a deterioration of Rs.216 million and Rs.30 million respectively as compared with the year under review with the preceding year, and the operating loss of Rs.45 million of the Machinery Division had mainly affected the deterioration of the net profit.

3.2 Analytical Review

The following observations are made.

(i) The net operating profits of the Consultancy, Special Operations and Machinery Divisions of the Corporation, for the year under review as compared with the preceding year had deteriorated by 24 per cent, 54 per cent and 1,205 per cent respectively.

(ii) The after tax net profit of the Corporation for all the years had decreased continuously except in the year 2011. The decrease of after tax net profit was 40 per cent in the year under review as compared with the preceding year.

(iii) The expenditure incurred by the Corporation on salaries, allowances, contract labour and other expenses relating thereto amounted to Rs.2,136.75 million and it represented 27 per cent of the turnover.

(iv) The net profit and the total comprehensive income had deteriorated by 42 per cent and 102 per cent as a percentage of the total turnover respectively in the year under review as compared with the preceding year.

(v) The financial liabilities had increased by 8 per cent as a percentage of the financial assets in the year under review as compared with the preceding year and total liabilities had increased by 15 per cent and 3 per cent as a percentage of liabilities and total assets respectively.

4. Operating Review

4.1 Performance

The following observations are made.

(a) The operating profit for the year 2012 amounting to Rs.41.33 million of the Ekala, Welikanda and Ratmalana work sites belonging to the Construction Components Division had deteriorated to Rs.7.06 million by 83 per cent in the year under review. The increase of other expenses except the sales cost of the work sites had affected this position.

(b) The Brick and Carpentry Products Yard at Dankotuwa belonging to the Construction Components Division had incurred a loss of Rs.3.15 million in the year under review and out of the past 16 years, losses had been incurred in 15 years. That accumulated loss amounted to Rs.28.9 million. The increase of the sales cost over the percentage of increase in the income of the work site had affected this position.

(c) The operating profit for the year 2012 amounting to Rs.15.40 million of the 03 work sites in Peliyagoda, Ratmalana and Colombo belonging to the Mechanical and Electrical Division had deteriorated to Rs.9.87 million by 55 per cent. The increase of other expenses except the sales cost of the aforesaid work sites had mainly affected this position.

(d) In the review of the operating activities of the Matale Dolomite Processing Yard belonging to the Mechanical and Electrical Division, out of the past 16 years, except the year 2006, all other years had run at a loss. The loss of Rs.0.85 million in the year 2012 had increased up to Rs.13.78 million by 1,521 per cent in the year under review. The accumulated loss during the entire period had been Rs.52.2 million. The increase of other expenses and the sales cost and the decrease of the turnover of the work site had mainly affected this position.

(e) The profit of the Consultancy Services Division of the Corporation in the year 2012 amounting to Rs. 124.54 million had deteriorated to Rs.94.6 million by 24 per cent in the year under review.

(f) Regional Offices and 15 work sites including the Head Office of the Machinery Division and the Main Stores at Kolonnawa had sustained an accumulated loss of Rs.98.16 million in the year under review.

(g) Even though the Regional Offices at Horana, Dambulla, Ampara, Kalmunai and Thamankaduwa as well as the work site at Mahiyangana had not earned any income whatsoever in the year under review, an expenditure amounting to Rs.27.89 million had been incurred for these work sites in the year under review.

4.2 Operating Inefficiencies

(a) Even though the Bank Overdraft Facility which can be obtained by the Corporation on Bank Bonds within the year under review had been limited to Rs.473.7 million, there had been instances in which the facility of Bank Overdrafts had been obtained up to Rs.555.75 million. Out of it, a sum of Rs.150 million had been obtained as a Temporary Bank Overdraft at an interest rate of 30 per cent. As such, the total Bank Overdraft interest paid by the Corporation for Bank Overdrafts in the year under review amounted to Rs.77.66 million.

(b) The loans on discounting bills amounting to Rs.50 million obtained in the preceding years by the Corporation on the unfavourable condition of liquidity prevailing in the Corporation had been increased up to Rs.100 million at an interest rate of 19 per cent during the year under review and the total interest paid in that connection in the year under review amounted to Rs.21.78 million.

(c) The legal ownership had not been obtained up to the end of the year under review for lands of about 30 acres in extent on which the Head Office and 08 Work Sites of the Corporation are maintained.

4.3 Management of Projects – Project for Asphalt and Crusher Machines Work Site

The following observations are made.

(a) The Corporation had not paid attention on matters such as failure in carrying out a feasibility study, identifying the objectives, goals and targets of the project, non - deployment of a qualified staff, Cost Management and Safety of Machinery and Maintenance and Development in the management and implementation of the Project for Asphalt and Crusher Machines Work Site of the Special Operations Division established with an investment of Rs.372 million in the year 2012. As such it had been unsuccessful by the end of the year under review.

(b) The loss of the aforesaid work site had been Rs.0.58 million and Rs.4.85 million in the year under review and the preceding years respectively.

(c) The crusher machine, generator and vehicles for transport of tar valued at Rs.203 million had not been made use of from 18 July 2012.

4.4 Transactions of Contentious Nature

The following observations are made.

(a) Even though a total of Rs.5,885,178 had been paid on 16 June 2011 to the Insurance Corporation of Sri Lanka for providing life insurance cover and medical insurance cover for the employees of the Corporation only for a period of one year from 16 June 2011 to 15 June 2012, this insurance cover had not been operative in the year under review.

(b) Machinery imported from China at an import value of Rs.1,339.3 million in the year 2012 had been valued by licensed Valuation Officers for a value of Rs.735.6 million in the year under review. It was not possible to be satisfied in audit with regard to the reasonableness of the initial valuation in view of the decrease in value by 45 per cent within a short period of one year from the purchase.

4.5 Uneconomic Transactions

The following observations are made.

(a) The Corporation had taken an interest from the year 2008 itself in earning income by carrying out construction works in foreign countries and had spent a sum of Rs.13 million in that connection. Nevertheless, the Corporation had failed to commence construction works in a foreign country, obtain contracts or earn any income whatsoever even by the end of the year under review.

(b) The Corporation had not taken action even up to the end of the year under review to recover the sum of Rs.5,958,715 deposited in a Bank Account in Doha in the year 2009 for the transactions of Sri Lanka State Engineering (Qatar) Corporation Ltd., established for commencement of construction works in foreign countries.

(c) The Corporation had to pay a sum of Rs.19.62 million as liquidated damages as a result of non- completion of contracts of constructions within the specified period in the year under review.

(d) Forty nine Sales Promotion Officers had been recruited without the approval of the Department of Management Services with the objective of spreading the civil works Island-wide and salaries amounting to Rs.16.93 million had been paid to them in the year under review. However, the turnover of production sites at places such as Matale and Dankotuwa had not increased even in the year under review and they had been running at a loss throughout. Even though a sum of Rs.35.74 million had been spent as business promotion expenditure in the year under review, no new projects whatsoever had been commenced.

4.6 **Losses and Damage**

A loss of Rs.186.96 million had been sustained on 34 projects as at the end of the year under review due to incurring of costs exceeding the contract value of the projects.

4.7 **Contract Administration**

In the issue of invoices by the Construction Division, there were instances of preparing and presenting the client with invoices in which a higher value exceeding the cost incurred had been included as well as invoices presented with a value very much less than the cost incurred. This situation had resulted in overstating the value of receivables from the clients and the value of payable to the clients included in the Current Assets and Current Liabilities.

4.8 **Resources of the Corporation given to other Government Institutions**

The following observations are made.

(a) The Corporation had released 36 motor vehicles to the Ministry of Construction and Engineering Services contrary to provisions in Section 9.4 of the Public Enterprises Circular No. PED/12 of 02 June 2003. A sum of Rs.28.73 million had been spent as fuel expenses and hire charges for the motor vehicles and a sum of Rs.8.23 million as well had been paid as salaries and overtime to 21 drivers released to the Ministry.

(b) Sums of Rs.2 million and Rs.0.91 million had been paid respectively as salaries to three Coordinating Secretaries to the Minister of the Line Ministry and five employees connected to the Jana Sevana Programme under the Line Ministry. Further, 12 employees of the Corporation had been released to the Line Ministry and a sum of Rs. 4 million had been paid to them as salaries.

4.9 **Human Resources Management**

The cadre approved by the Department of Management Services had been 2,883 and the actual cadre as at 31 December of the year under review had been 3,102. As such, an excess of 219 employees was observed. The following observations are made in this connection.

(i) Six hundred and eleven vacant positions had existed in the permanent cadre of the Corporation as at 31 December of the year under review. The number of employees recruited on contract basis without approval had been 816 and the number of casual employees had been 14. As such, the entire cadre had exceeded by 219 employees.

(ii) Action had not been taken from the year 2008 even up to the end of the year under review to recruit 64 officers relating to 13 posts in the Top Management Level of the Corporation and it had directly affected the performance of the Corporation.

(iii) Ninety six officers had been recruited on contract basis for 14 posts representing the Top Management of the Corporation from the year 2006 and the employee turnover of those officers had been high.

5. Accountability and Good Governance

5.1 Presentation of Financial Statements

Even though the draft annual financial statements should be presented to the Auditor General within 60 days of the close of the year of accounts in terms of Circular No. PED/12 of 02 June 2003 of the Department of Public Enterprises, the financial statements for the year under review had been presented to the Auditor General only on 10 December 2014 that is after a delay of 285 days.

5.2 Corporate Plan

The Corporate Plan prepared for the period from 2012 to 2015 in terms of the Circular No. PED 47 of 18 December 2007 of the Department of Public Enterprises and Chapter 5 of the Guidelines on Good Governance of the Department of Public Enterprises had not been updated relating to the period from 2013 to 2016.

5.3 Action Plan

(i) The Corporation had failed to execute 08 activities which should be executed by the Corporation in the year under review, included in the Action Plan presented in respect of the year under review and included in the Corporate Plan prepared for the period from 2012 to 2015.

(ii) Even though the targets and activities to be reached by the officers in charge of each duty relating to the annual activities included in the Action Plan had been indicated, the relevant targets had not been shown as quantitative values.

5.4 Budgetary Control

Significant variances were observed between the budgeted and actual income and expenditure, thus indicating that the budget had not been made use of as an effective instrument of management control.

5.5 Annual Reports

The Corporation had not tabled the Annual Report for the year 2012 in Parliament even by 08 April 2015.

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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 Corporation from time to time. Special attention is needed in respect of the following areas of control.

(a) Contract Administration
(b) Advances Control
(c) Inventory Control
(d) Accounting
(e) Human Resources Management
(f) Tax Management
(g) Procurement Process