Central Engineering Consultancy Bureau (CECB) - 2014

The audit of financial statements of the Central Engineering Consultancy Bureau (CECB) and the consolidated financial statements of the CECB and its Subsidiary for the year ended 31 December 2014 comprising the statements of financial position as at 31 December 2014 and the statements of comprehensive income, statements of changes in equity and cash flow statements 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 Corporation Act, No. 49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Bureau in terms of Section 14 (2) (c) of the Finance Act appear in this report. The financial statements of the Subsidiary were audited by a firm of Chartered Accountants in public practice appointed by the Board of Directors of the respective Subsidiary.

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 Auditors' 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 Auditing 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 misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bureau'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 Bureau'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 the 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 opinion.

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraphs 2.2 and 2.3 of this report.

2. Financial Statements

2.1 Opinion

(a) **Qualified Opinion – Group**

In my opinion except for the effects of the matters described in paragraphs 2.2 and 2.3 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 2014 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(b) **Qualified Opinion – CECB**

In my opinion, except for the effects of the matters described in paragraph 2.3 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 2014 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Group Financial Statements

The following observations are made.

(a) The auditors of the Central Engineering Services Limited (CESL), the Subsidiary of the CECB, had expressed a qualified opinion on the financial statements for the year under review based on the following matters.

(i) Construction Revenue

Contract agreements in respect of several construction contracts entered by the Subsidiary with the Central Engineering Consultancy Bureau (CECB) were not provided for audit. Hence, it could not verify the accuracy of contract value amounting to Rs. 8,860,283,658. Accordingly, it was unable to state that the construction revenue from CECB amounting Rs. 860,857,496 is fairly stated in the financial statements.

(ii) Property, Plant and Equipment and Inventories

The Subsidiary has neither made any adjustments for discrepancies identified at the annual physical verification of fixed assets and stocks nor made any provisions for fixed assets and stocks which are not in usable conditions. Accordingly, this is a deviation from Sri Lanka Accounting Standards: LKAS 36: Impairment and Sri Lanka Accounting Standards: LKAS 02: Inventories.

Further, the Subsidiary has not carried out annual physical verifications at Head Office, Common Base and four Projects' sites at Ampara base, covering total assets costing Rs. 180,724,757.

Also, differences were revealed between the detailed and summarized stock reports generated from the stores management system and it was observed that the general ledger balances of fixed assets could not be traced directly to the balances of the stores management system.

Accordingly, I am unable to satisfy my selves as to the existence, accuracy, valuation and completeness of Property Plant & Equipment and Inventories stated in the financial statements.

2.3 Comments on Financial Statements of the Bureau (CECB)

2.3.1 Comply with Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) **LKAS 11-Construction Contract**

The CECB had identified the number of construction contract as a single contract in contrary to the provisions in the standard, 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.

(b) **LKAS 24 – Related Parties and Related Party Transactions**

Involvement of the management of the CECB in operational activities of the Subsidiary i.e. the Deputy General Manager (Finance) of the CECB employing as a Finance Manager of the Subsidiary and the Additional General Managers of the Base Offices of the CECB employing as operational managers of the Base Offices of the Subsidiary had not been disclosed in the financial statements.

2.3.2 Accounting Deficiencies

The following observations are made.

(a) There was no any contract variation in respect of Project Numbers D1752 and D1459 as at 31 December 2014. However, a sum of Rs.29,725,756 had been taken into account as provision for contingencies in computation of the profit of those Projects for the year 2014 based on the percentage of completion method. As a result, the revenue for the year under review had been overstated by Rs.18,001,315.

(b) Cash received from the sale of redundant stock items at Gampaha base office was amounting to Rs.248,180 while the book value of those items was Rs. 147,650. However, the above difference had not been adjusted in the financial statements for the year under review.

(c) The contract amount for the construction of official residencies for the use of staff attach to the High Commissioner of Sri Lanka in London was Rs. 794,805,809. According to payment certificate submitted by the CECB during the year under review certified works and cash received were Rs. 762,904,603 and Rs. 543,902,642 respectively. However, debtor balance of Rs.109,261,571 and the balance due to customer of Rs.4,652,095 had not been shown in the financial statements of the International Division. Hence, debtor balance and balance due to customer had been understated by these amounts.

(d) A sum of Rs.1, 048,954 paid for goods received during the year 2014 had not been deducted from creditor balance. As such the creditor balance for the year under review had been overstated by that amount.

(e) The receivable and payable balances of Rs.4,086,494 and Rs. 210,597 respectively relating to fully completed construction contracts had been shown in the financial statements without being cleared those balances.

(f) Adjusted contract value of Rs. 701,343,919 relating to fully completed nine projects had not been taken into accounts in ascertaining the contract revenue of the year under review. As a result, the construction revenue shown in the financial statements had been understated by Rs.93,795,134.

2.3.3 Accounts Receivable and Payable

Debtor balances of the Engineering Procurement Contract Division and Consultancy Division amounting to Rs. Rs.59,128,609 and Rs.77,089,879 respectively had remained outstanding for more than five years as at 31 December 2014 and those balances had not been recorded even as at 31 March 2016.

2.3.4 Lack of Evidence for Audit

The Base Offices of the CECB had not maintained a register for retention money by showing the amounts payable to the sub-contractors and a schedule for retention money of Rs.20,888,711 payable to sub-contractors as at the end of the year under review had not been submitted to audit. Therefore, the accuracy and reliability of retention money payable shown in the financial statements could not be ascertained in audit.

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

Instances of non-compliance observed in audit are given below.

Reference to Laws, Rules, Regulations etc.		Non-compliance
(a)	Section 14(1) of the Finance Act, No.38 of 1971	A copy of the Draft Annual Report for the year under review had not been submitted to the Auditor General.
(b)	Public Enterprises Circular No. 95 of 04 June 1994	Various allowances such as retaining allowances, personal allowances, and professional allowances had been paid to the permanent and contract employees of the CECB without the approval of the General Treasury. Total amount of such allowances paid in the year under review was Rs.228,806,607.
(c)	Guideline 4:2:1 of the Government Procurement Guidelines - 2006	A Master Procurement Plan for the year under review had not been prepared.
(d)	Department of Management Audit Circular No: DMA/2002/(2) dated 28 November 2002 and Financial Regulation 802 (1)	Assets register had not been maintained by the Northern Road Division and International Division of the CECB with adequate details.
(e)	Financial Regulation - 135	Preparation, authorization and certification of payment vouchers had been done by the same officer of the International Division.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the CECB and the Group for the year under review had resulted in a pre –tax net profit of Rs.536,383,250 and Rs.668,173,035 respectively as compared with the corresponding pre-tax net profit of Rs.584,746,149 and Rs.610,013,445 respectively for the preceding year, thus indicating a deterioration of Rs.48,362,899 and an improvement of Rs.58,159,590 respectively in the financial results. Decrease of the construction revenue as compare with the previous year was the main reason attributed for the deterioration in the financial statements of the CECB.

3.2 Analytical Financial Review

The following observations are made.

(a) The CECB had earned a pre- tax net profit of Rs.536,383,250 during the year under review by utilizing its staff strength of 1,620 employees and total assets base of Rs.17,027,483,910. Thus, the profit represented 3.15 per cent of the total assets of the CECB.

(b) Revenue of the Construction Division had decreased from Rs.13,042,021,420 to Rs.11,127,444,260 in 2014 representing 14.6 per cent decrease as compared with the preceding year.

(c) Operating profit margin and net profit margin of the year under review were 3.08 per cent and 2.21 per cent respectively as compared with the previous year. Hence, the profit margins had increased by only 0.25 per cent and 0.05 per cent respectively.

4. Operating Review

4.1 Performance

Even though the CECB was constituted in 1973, mainly to undertake consultancy works to fulfill national needs in Sri Lanka and the CECB Consultancy Division equipped with all needed physical and human resources to serve the nation with all types of engineering consultancies. However, at present the CECB had mainly focused on construction works rather than involving in consultancy works.

Out of the operating revenue of the Bureau for the year 2014, only 15.8 per cent had been earned on providing consultancy and the balance had been earned from construction works. There are number of state owned institutions to undertake construction works such as State Development and Construction Corporation, State Engineering Corporation, Building Department etc. But consultancy works are undertaken only by the CECB and State Engineering Corporation. Thus, the 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 works seems to be higher in construction works. The higher trend of dependency on construction works rather than engineering consultancy, the CECB would probably loss the strategic and unique opportunity given by the mandate to outperform in the area of engineering consultancy which is in the national interest. Therefore, CECB need to be more focused on engineering consultancy works by maximum utilization of its experts in this field in order to achieve the main objectives of the CECB.

4.2 Transactions of Contentious Nature

The following observations are made.

(a) As reported in my previous year audit reports, out of assets valued at Rs. 3,601 million received to the CECB from the Ministry of Economic Development as capital grant to carry out the road projects in 2012. A sum of Rs. 250 million had been recovered by the Ministry of Economic Development from the contract payments made in 2013. Moreover, without carrying out any professional valuation of those assets and ignoring the grant portion of Rs.3,351 million, the CECB had accounted only Rs.250 million as an asset.

(b) The CECB pays Nation Building Tax (NBT) and Value Added Tax (VAT) on cash basis in contrary to the provision in the Nation Building Tax Act No. 09 of 2009 and Value Added Tax Act No. 14 of 2002.

(c) The Board of Directors of the Bureau had approved number of incentive schemes and incentive payments to its staff without getting prior approval from the General Treasury. Total amount of such incentives paid in 2014 was Rs.101,116,669.

(d) Out of 90 per cent of the construction contracts undertaken by the CECB had been sub-contracted to its Subsidiary i.e. Central Engineering Services Limited- CESL without allowing them to get contracts through competitive bidding, which is the main purpose in establishment of that Company.

It was further observed that the above works had been carried out by the Subsidiary by using human, physical and other resources belonging to the CECB i.e. preparation of BOQs, estimates and invoices for both organizations are done by the same personnel of the CECB.

4.3 Irregular Transactions

The following observations are made.

(a) Value Added Tax (VAT) aggregating Rs.9,992,930 had been paid by the CECB to 40 contractors without examining the validity of VAT registration numbers and VAT invoices at the time of the payments were made. Subsequently it was found that VAT numbers and names indicated by the contractors were inactive.

(c) Even though a debtor balance of Rs.169,932,979 relating to consultancy services provided for construction of Defense Head Quarters at Akuragoda had been shown in the financial statements as at the end of the year 2014, the agreement with the Ministry of Defense had been entered only on 18 September 2015 at a contract price of Rs.1,556,900,395. It was further observed that the CECB had provide the consultancy services for this construction since the year 2012.

4.4 Identified Losses

The following observations are made.

(a) The contract value of the Project bearing No. 1235 approved by the Standard Technical Committee on 23 July 2013 was Rs.115, 428,867. However, the actual cost incurred for that project was Rs.133,100,436 and out of that a sum of Rs. 126,908,006 only had been received from the client. Hence, the loss sustained to the CECB on this project was Rs. 6,192,430.

(b) Loss of Rs. 42,473,362 had been incurred during the year under review in respect of 51 construction contract works undertaken by the Bureau due to improper accounting and poor contract administration.

4.5 Human Resources Management

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The approved and the actual cadre of the Bureau as at 31 December 2014 was 1,620 and 1,369 respectively. Accordingly 251 vacancies therein were in approved cadre in all types of employee categories. Taking adequate action to fill these vacant posts was not observed in audit.

5. Accountability and Good Governance

5.1 Corporate Plan

Even a Corporate Plan for the period 2014-2016 had been prepared an adequate attention had not been made for the following salient features in accordance with the Public Enterprise Circular No. PED 12 of 02 June 2003.

i. The current resources available to the Bureau under following categories had not been included.
   - Land and Building
   - Technical Know- how
   - Construction and operating facilities

ii. A review of the preceding three years' operating result had not been embedded.

iii. Responsibility of achieving the goals and targets within the planed period had not been fixed.

iv. No strategies, especially, for construction and consultancy operations had been formulated.

v. The Plan had not been approved by the Board of Directors and circulated to the relevant authorities 15 days before the commencement of the financial year.

vi. The Plan had not been revised annually as a rolling plan.

5.2 Budgetary Control

Significant variances were observed between the budget and actual figures thus indicating that the budget had not been made use of as an effective instrument of management 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 CECB from time to time. Special attention is needed in respect of the following areas of control.

(a)	Assets Management	Asset received from the Ministry of Economic Development for the road projects had not been fairly valued and brought to the financial statements as at end of the year under review.

(b)	Inventory Control and Stock Management	Inventory and stock at site as at the end of the year under review had not been brought to the financial statements.
(c)	Invoicing	The value of actual works of the construction contracts had not been brought to the financial statements.
(d)	Debtors and Receivables	Corporation had not taken any action to recover the balances of debtor and receivable.
(e)	Accounting	Some transactions had not been properly accounted