National Engineering Research and Development Centre of Sri Lanka - 2014

The audit of financial statements of the National Engineering Research and Development Centre of Sri Lanka for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 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 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 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 the 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 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 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.

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 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 National Engineering Research and Development Centre of Sri Lanka as at 31 December 2014 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 Non-compliance with the Sri Lanka Public Sector Accounting Standards

The following Non-compliances with Sri Lanka Public Sector Accounting Standards were observed in audit.

(a) In terms of Sri Lanka Public Sector Accounting Standard 01, assets settled within 12 months after the date of reporting, should be shown as current assets, whereas all other assets should be shown as non-current assets in the statement of financial position. Nevertheless, staff loans amounting to Rs. 17,843,909 granted to the staff of the Centre that should be settled within a period of 01-15 years, had been shown as current assets.

(b) In terms of Sri Lanka Public Sector Accounting Standard 07, Property, Plant and Equipment should be revalued inclusive of the entire class to which the asset belongs. However, the Center had not taken steps to revalue the entire asset class of motor vehicles, and machinery.

(c) In preparing the cash flow statement in accordance with Sri Lanka Public Sector Accounting Standard No. 03, only the cash transactions should be taken into consideration. However, the motor vehicle valued at Rs. 9,500,000 that had been received by the Center as a Government grant, had been shown under the cash flow received from the financial activities by considering receipts of cash, and the same had also been shown under the investment activities as purchases of fixed assets.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) Seven day's call deposits of Rs. 31,400,000 which should have been shown under cash and cash equivalents, had been shown as deposits of more than 03 months under the current assets.

(b) An interest of Rs. 2,139,720 up to the year under review with respect to the sum of Rs. 8,994,089 deposited in the public institutions temporary surplus fund in the year 2010, had been added to the value of the deposit. However, it had been shown as an interest further receivable.

(c) The expense of capital nature amounting to Rs. 4,206,758 incurred on fixing accessories to the CNC Milling machine, had been accounted as an expenditure for repairs.

(d) As test reports had been issued with respect to 85 samples of electric lamps received by the Center during the period from 2009-2011 without issuing invoices, test fees amounting to Rs. 525,506 had not been accounted. Action had not been taken to recover the said amount even by the end of the year under review.

(e) Museum artefacts identifiable as non-depreciable assets, had been depreciated by 15 per cent. The depreciations for the year under review amounted to Rs. 656,261, whereas the accumulated depreciations for the preceding years amounted to Rs. 654,185.

(f) Consumable goods valued at Rs. 2,930,950 had been included in the fixed assets valued cost at Rs. 1,071,929,562 shown in the statement of financial position as at 31 December 2014.

2.3 Accounts Receivable and Payable

The following observations are made.

(a) The debtor balance of Rs. 2,936,827 comprising 17 trade debtor accounts as at 31 December 2014 included debtors balances amounting to Rs.507, 983 between one year and 3 years old, and debtors balances amounting to Rs.637, 056 older than 9 years.

(b) The trade creditors balance included unsettled balance of Rs.252,160 older than 6 years and Rs.198, 812 not settled for more than 02 years.

(c) Value added tax amounting to Rs. 29,316,666 that remained receivable to the Centre from the Department of Inland Revenue from 2005 to 2014, and withholding tax amounting to Rs. 239,092 had not been recovered even in the year under review.

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

The following non-compliances with laws, rules, regulations and management decisions were observed.

Reference to Laws, Rules and Regulations	Non-compliance
(a) Section 8(ii) of the Finance Act, No. 38 of 1971, 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. 77,000,000 had been invested in seven day's call deposits at a State bank without approval of the Minister of Finance and the relevant Minister.
(b) Public Finance Circular, No. 438(2) of 13 November 2009.	A comprehensive report including the balance as per the inventory, physical balance, excess and shortage should be presented by

	physically verifying the fixed assets of the Centre. However, only a report including shortage of goods and damaged stocks had been presented to the audit in connection with fixed assets costing Rs.1,071,929,562.
(c) Section 8.9.1(a) of National Procurement Guidelines dated 25 January 2006	Despite sums of Rs.1,544,880 and Rs.2,661,878 had been paid by the end of the year under review to a local and a foreign company respectively for repairing the CNC Milling machine at the designing and consultancy services division, a formal agreement had not been signed.
(d) Section 9:3:1 (a) of the 19th Supplementary to the Procurement Handbook dated 06 September 2010.	Although approval of the Secretary to the Line Ministry should have been obtained for expenses exceeding Rs. 200,000 incurred on the repairs of equipment and motor vehicles, no such approval had been obtained for the repairs of 2 vehicles, for which a sum of Rs. 2,402,660 had been incurred.

2.5 Transactions not Supported by Adequate Authority

The following observations are made

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(a) On a decision taken by the Board of Management, sums of Rs. 9,050,398, and Rs. 7,972,532 had been paid as incentives in the year under review and the years 2012 and 2013 respectively without obtaining the approval of the Department of Management Services.

(b) In accordance with the Management Services Circular, No. 02/2014 of 11 February 2014, approval for the payment of research allowances should be obtained by presenting an inter-research report including the progress of the relevant proposal as per the Action Plan, to the Research Management Committee within 6 months since the commencement of the research. Nevertheless, research allowances amounting to Rs. 464,126 had been paid to 03 officers of the Center from July 2014 to April 2015 without such an approval.

(c) A sum of Rs. 4,500,000 deposited in the seven day’s call deposits had been utilized for granting loans to the staff without obtaining Treasury approval in that connection.

(d) A scheme for granting a loan amounting to Rs. 1,000,000 to the engineers of the Centre for purchasing motor cars at an annual interest of 4.2 per cent had been implemented by utilizing the profit of the commercial projects without Treasury approval. Thus, a sum of Rs. 6,000,000 had been granted to 06 engineers without proper approval, and 04 officers who obtained vehicles duty free concession from the Government, had also obtained those loans.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Centre for the year ended 31 December 2014 had resulted in a deficit of Rs.19,383,328 as compared with the corresponding deficit of Rs.28,114,859 for the preceding year. As such, an improvement of the financial result amounting to Rs. 8,731,531 had been observed. The increase in the other income by 27 per cent as compared with the preceding year, and the decrease in the other operating expenses by 56 per cent had mainly contributed to the improvement of the financial result.

4. Operating Review

4.1 Performance

The following observations are made.

(a) According to the Action Plan, it had been planned to incur a sum of Rs. 18,138,000 in the year under review on research and development expenses. However, only a sum of Rs. 8,317,497 representing 3 per cent of the total expenditure of the year had been incurred. Furthermore, research and development expenses had decreased by 29 per cent as compared with the preceding year. Although it is a main duty of the Centre to perform duties relating to the research and development, expenses on the research and development had rapidly decreased over the past few years, and only a small amount from the total expenditure had been incurred on the research and development activities.

(b) The following observations are made in the examination of the performance of various divisions in the year under review with the Action Plan.

(i) Although it had been planned by the designing and consultancy services division to earn an income of Rs. 6,500,000 by completing 120 orders to supply various dye and mould designing services, a sum of Rs. 1,561,000 had been earned by supplying only 48 services by the end of the year under review. The number of orders undertaken had rapidly decreased as the CNC Milling machine being used in this section, had become inoperative.

(ii) Although it had been planned by the aforesaid division to implement a project to design an automatic gem cutting machine in the year under review, the project had not been commenced.

(iii) Despite plans to earn an income of Rs. 3,300,000 by providing consultancy services for the construction of buildings, only an income of Rs. 600,000 had been earned by the end of the year under review.

(iv) Despite plans to earn an income of Rs. 600,000 from the "Flap Gates" Project, the expected income had not been yielded by the project during the year under review.

(v) The project implemented with the objective of introducing the low-cost construction methodology utilizing the technology of the Center to the Government sector, had not yielded the expected results. Although it had been expected to earn an income of Rs. 1,000,000 in the year under review, the expected income had not been earned, but expenses amounting to Rs. 619,051 had been incurred.

(vi) Although it had been expected to earn an income of Rs. 5,500,000 by implementing a commercial project to construct a crematorium in the year under review, the expected income had not been earned as the project had not been implemented.

(vii) Despite plans had been made to provide consultancy services for the construction of library buildings in Hambanthota and Puttalam districts, the projects had not been implemented.

(viii) Instances where expected targets of the technological marketing division had not been achieved by the end of the year under review, were observed. Particulars are as follows.

	Target	Actual Performance
(i)	Earning an income of Rs. 732,000 by issuing 62 technical transfer licenses.	An income of Rs. 139,000 had been earned by issuing only 21 technical transfer licenses.
(ii)	Publication of 17 research papers	Only 2 research papers had been published.
(iii)	Formulation of a policy for intellectual properties	Despite being commenced in the year 2013, preparation had not been completed in the year under review.

(ix) The NERD Centre had expected to earn an income of Rs.1,900,000 by conducting 22 training programs. Nevertheless, only an income of Rs.868,538 had been earned by conducting 14 programs.

(x) Although it had been planned in the Action plan from the year 2011 to 2014 to implement ISO 9001 certification system at the NERD Centre, it had not been implemented even by the end of the year under review.

4.2 Management Inefficiencies

Despite a sewage system had been constructed by the Centre and handed over to the Negambo Urban Council, the Urban Council had refused to pay the balance of Rs. 2,128,636 receivable to the NERD Centre as the sewage system had not been operational. That amount had been written off from the accounts in the year under review.

4.3 Operating Inefficiencies

The following observations are made.

(a) As the orders received in the preceding years had decreased due to delays in issuing reports to the client institutes, the income earned from the commercial project of the Centre to inspect the imported batteries , had rapidly decreased. The income received from this project during the year under review amounted to Rs. 14,918, whereas the battery tester and other equipment purchased at a cost of Rs. 11,949,980 for inspecting the imported batteries, had remained under-utilized.

(b) The Centre had been given 83 electric lamps valued at Rs. 1,049,369 in the year 2011 for sample checks. However, the sample tests had not been conducted even by December 2014.

(c) Activities relating to 10 research projects implemented by the Centre at a cost aggregating to Rs. 9,071,303 had been completed though, the final reports had not been presented even as at 31 December of the year under review.

(d) The following observations are made in connection with the issue of licenses and vesting of the technology possessed by the Centre.

(i) The number of technologies and technological instruments introduced within a period of 5 years from 2010 to 2014 was 19, whereas technology transfers had been provided only for 03 instruments introduced in the years 2010, 2011.

(ii) There had been 898 registered license holders for 49 technological instruments introduced by the Centre, of whom only 83 had renewed the licenses in the year 2014, whereas 299 license holders who had obtained licenses for 30 technological instruments had completely given up renewing licenses.

(iii) Thirty five licensees for reinforced yards and 398 licensees registered for the economical construction of buildings had registered prior to the year 2005. They had not renewed their licenses due to technology had become obsolete, and the NERD had not been able innovate the technology to be in line with the present day.

(e) In terms of Section xiv 83(2) of the Intellectual Property Act, No. 36 of 2003, where a patentee intends at the expiration of the second year from the date of grant of the patent to keep the same in force, he shall twelve months prior to the date of expiration of the second and each succeeding year during the term of the patent, pay the prescribed annual fee and renew the patent. However, 28 patents had not been renewed up to the year 2014. Although 07 applications had been presented since the year 2002 to obtain patent rights with respect to new technological instruments, patent rights had not been obtained even by the end of the year 2014.

4.4 Idle and Under-utilized Assets

The following observations are made.

(a) Ninety five items of Nonmoving stocks valued at Rs. 1,097,383, and 8 items of damaged stocks valued at Rs. 52,104, had remained underutilized for a period of over 14 years.

(b) Machines and equipments purchased at Rs. 45,971,236 for various divisions of the Center had remained idle and underutilized for a period of 3-8 years.

(c) A model house had been constructed at the technology park of the Centre in the year 2013 spending a sum of Rs 3,710,425 with a view to examining the actual cost being incurred in constructing a house utilizing the technology of the Centre, but action had not been taken to make use of this house.

4.5 Identified Losses

As expenses had exceeded the income in connection with 02 commercial projects implemented by the Centre, the Centre had incurred a loss of Rs. 609,726.

4.6 Contract Administration

The Centre had been awarded the contract for the construction of Nurses Quarters Building of the Polonnaruwa General Hospital by the Ministry of Health at a cost of Rs. 22,520,010. The matters observed in that connection are as follows.

(a) The construction was commenced on 15 March 2011 and scheduled to be completed by 15 July 2011. However, the construction had been completed on 02 February 2013.

(b) The Centre had amended the construction design by preparing estimates amounting to Rs.24,293,400, and construction had been carried out accordingly. As the estimate so amended, had not been approved by the Technical Evaluation Committee, it had not been possible to sign the agreements.

(c) The Bill No. 07 valued at Rs. 29,450,947 had been presented to the Ministry of Health on 18 January 2013 , and a sum of Rs. 20,274,560 had been received. Although a sum of Rs. 9,176,387 remained receivable from the Ministry of Health , it had not been recovered even by the date of audit on 30 June 2015, and action had not been taken to present the final bill.

The maintenance period had lapsed by 02 February 2014 though, retentions amounting to Rs. 1,214,670 could not be recovered as the defects had not been revamped.

According to the Bill No. 07, there had been extra works valued at Rs 2,984,169 and price fluctuations valued at Rs. 2,047,560, and approval of the Ministry had not been received in that connection.

4.7 Delayed Projects

The following observations are made.

(a) Project for the manufacture of a bakery oven with bio-fuel thermostatic controller

The Project for the manufacture of a bakery oven using bio-fuel commenced on 09 January 2012, was scheduled to be completed by 31 December 2012 with an estimated cost of Rs. 400,000. Completion of the project within the specified duration had failed, and approval for additional provisions totalling Rs. 6,366,000 that represented 16 times of the originally estimated cost, had been obtained in several instances by October 2014. This project had been scheduled to be completed by 31 October 2014. However, the project had not so far been completed despite a sum of Rs. 3,496,796 had been incurred by 31 December 2014.

(b) Project for the manufacture of a Robot

A sum of Rs. 1,132,471 had been given to the University of Moratuwa by entering into a memorandum of understanding for the project commenced with a view to manufacturing a robot. This project commenced in January 2012 had been scheduled to be completed by January 2013. However, the project had been completed by December 2013, but the robot had not functioned as expected.

4.8 Inoperative Projects

No progress had been observed in connection with 07 research projects with an estimated cost of Rs. 6,785,000 that had been scheduled to be commenced and completed within the year under review. The objectives of the projects could not be achieved as the projects had not been completed on time, whereas duration of some projects had exceeded, and even the project periods had not been extended.

4.9 Personnel Administration

The following observations are made.

(a) The cadre approved by the Department of Management Services was 311. There had been 65 vacancies in the executive and non-executive grades , and 15 excesses in the executive grades by 31 December 2014.

(b) Instances of employees recruited on contract basis contrary to the scheme of recruitment, had been observed.

(i) Although an experience of 15 years is required by the scheme of recruitment for the post of Director (Human Resources), a female officer who had not possessed such an experience had been recruited as Manager (Human Resources) - a title not in the approved scheme of recruitment, for a period of 01 year with effect from 01 August 2014.

(ii) An employee had been recruited for the post of Machine Operator on contract basis contrary to the scheme of recruitment, and a monthly allowance amounting to Rs. 22,971 had been paid since May 2014. Five employees who had not possessed a 01 year experience had been recruited contrary to the scheme of recruitment, and sums of Rs. 170,626, and Rs. 283,723 had been paid as monthly allowances and contributions to the provident fund in the year 2013 and the year under review respectively .

(iii) A sum of Rs. 167,358 had been paid as allowances and EPF in the year under review by recruiting an employee on contract basis in excess of the approved cadre for a period of 01 year with effect from 19 June 2014.

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

(a) Costing and Management of Projects
(b) Debtors
(c) Motor Vehicles Control