State Engineering Corporation of Sri Lanka – 2015

The audit of financial statements of the State Engineering Corporation of Sri Lanka for the year ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 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

The 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 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 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 effect 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 2015 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 Sri Lanka Accounting Standards

The following observations are made.

(a.) Sri Lanka Accounting Standard 01

Despite being stated in paragraph No. 32 of the Standard that assets and liabilities, and income and expenditure should not be set off against each other unless required or permitted otherwise by the Sri Lanka financial reporting standards, the debit and credit balances of the account payable to the sub-contractors had been set off against each other according to the audit test check. Hence, the credit balance of the creditors had been understated by a sum of Rs. 110,764,584.

(b.) Sri Lanka Accounting Standard 02

According to the Standard, the stock should be valued at cost or net realizable value, whichever is less. Nevertheless, the stock of finished goods and raw materials existed as at 31 December 2015 had been valued by considering 92.5 per cent of the net realizable value as the cost. As such, it was observed that the stocks could be over-computed or under-computed as the stocks had been valued without identifying the cost accurately.

(c.) Sri Lanka Accounting Standard 16

As the useful life of non-current assets had not been reviewed annually, fixed assets costing Rs. 68,197,875 had still been in use despite being fully depreciated. Action had not been taken to revise the estimated error in accordance with the Sri Lanka Accounting Standard 08.

(d.) Sri Lanka Accounting Standard 37

The following observations are made.

(i) Although provision for contingent liabilities should be made in respect of the commitments which could be specifically recognized, no provision whatsoever had been made in the financial statements for commitments valued at Rs. 16,234,441 that had been specifically recognized relating to 02 court cases filed against the Corporation.

(ii) No provision had been made in the financial statements in respect of the unpaid fines on Value Added Tax totalling Rs. 121,782,475 for the years 2014 and 2015, and the fine of Rs. 6,941,026 relating to the year 2013.

(iii) As no provision had been made in respect of the fines amounting to Rs.3,008,204 payable due to delays in paying gratuity, the loss of the year under review had been under-computed by that amount.

2.2.2 <u>Accounting Deficiencies</u>

The following observations are made.

(a.) The rental receivable from the Sri Lanka Cement Corporation in respect of the northern section of the seventh floor, totalled Rs. 8,461,726 as at 31 December 2015, but that amount had been accounted as Rs. 9,172,403, thus overstating the current assets and the loss of the year by a sum of Rs. 710,677.

(b.) The southern section of the seventh floor had been leased out to the Sri Lanka Cement Limited, and the rental thereof for the year 2014 and the year under review had been understated by sums of Rs. 2,130,566, and Rs.2,934,180 respectively. As such, the loss had been overstated whilst the assets receivable had been understated in respect of those years.

(c.) Instead of being adjusted retrospectively, the net profit of 06 projects totalling Rs. 996,342 in respect of the works carried out in the preceding years, had been adjusted to the profit of the year under review. Hence, the loss of the year had been under-computed by that amount.

(d.) As the extra works recognized for the year 2014 had not been continued in the year 2015, the loss of the current year had been over-computed by a sum of Rs. 2,119,798.

(e.) A cost of Rs. 11,030,827 had been indicated at the commencement of the year relating to the contracts continued to exist over several years in respect of 07 sites belonging to the Construction Division, and a site belonging to the Equipment and Machinery Division, but the profit of Rs. 1,355,242 relating thereto had not been identified. Hence, the accumulated loss had been over-computed by that amount as at 31 December 2015.

(f.) Due to failure in taking action even up to the end of the year under review to recover the monies recoverable from the relevant contractors in respect of 03 sites for which costs had been incurred in excess of the contract value, the adjusted income had not been recognized. Accordingly, the accumulated cost amounting to Rs. 8,366,810 had been recognized as a loss, thus over-computing the loss of the year by a sum of Rs. 389,529.

(g.) As 02 items of final stock pertaining to the housing scheme in Angoda had been double counted, the final stock had been over-computed by a sum of Rs.396,206.

(h.) Action had not been taken to assess the value of 18 items of Timber stocks existed at the stores in Ratmalana, and bring into accounts.

(i.) The items of the category "N" (less than one year) included in the slow moving stock for the year 2014 in respect of the Site Nos. 1099, 237, and 343 had remained unchanged even in the year 2015. Those stocks should have been categorized as "N1" (More than one year), but it had not been done so. As the value of the said slow moving stock amounted to Rs. 11,451,602, provision equivalent to 15 per cent should have been made thereon. Nevertheless, action had not been taken accordingly, thus over-computing the stock value by a sum of Rs. 1,717,740, and under-computing the loss of the year under review by that sum.

(j.) According to the audit test check, the finished stocks relating to Site Nos. 343 and 237 had been valued in a manner that the verification value for the year 2015 of the items existed over a period of one year (N1), and more than 02 years (N2) had been overstated by a sum of Rs. 677,338 as opposed to that of the year 2014. As such, the loss of the year had been understated whilst the value of the assets had been overstated by that amount.

(k.) Credit balances valued at Rs. 1,433,820 had been observed in the register of costs valued at Rs. 3,967,410,436 presented in terms of sites, and the cost of sales had been devalued by that value.

(l.) It was observed in the audit test check carried out on the allocation of provision for the impairment on debtors that provision amounting to Rs.74,584,331 had been made in excess of the actual debtor balance.

(m.) The value of the land in Ekala with an extent of 13 acres, 03 roods and 35 perches vested in the Corporation in terms of Section 44 of the Land Acquisition Act, had not been brought to the accounts of the year under review.

2.2.3 <u>Unexplained Differences</u>

The following observations are made.

(a.) According to the stock survey reports, it was observed in the comparison of physical stock balances with the bin card balances as at 31 December 2015 that a shortage of Rs. 5,297,373 had existed in the values of stock items relating to 149 bin cards whilst a surplus of Rs. 3,243,713 had existed in respect of 57 bin cards.

(b.) According to the financial statements of the year under review, the economic services fee payable amounted to Rs. 19,903,480, but the said value amounted to Rs. 6,767,360 according to the schedule, thus observing a difference of Rs.13,136,120.

(c.) The balance of the provision for impairment account amounted to Rs.117,697,607 as at 31 December 2015 in accordance with the Sage Software of the E&M Division. However, according to the schedule presented, the said balance amounted to Rs. 117,687,606 indicating a difference of Rs. 10,001.

(d.) Due to failure in correctly identifying the entries on the individual debtor balances as at 31 December 2015, an unusual debtor balance of Rs.106,981,333 had resulted in the debtor balance.

(e.) According to the schedules of the Machinery and Equipment Division presented, a sum of Rs. 173,856,115 had remained receivable from the customers whereas the said value amounted to Rs. 197,876,934 in accordance with the closing financial statements, thus observing a difference of Rs.24,020,819.

(f.) The cost of 02 sites for the year under review belonging to the Construction Equipment Division and the M & E Division indicated a minus value of Rs.223,839, and no explanation had been made as to how this unusual balance had resulted.

(g.) The audit test check conducted on the verification of debtor balances with respect to information received from 05 institutions revealed that a difference of Rs. 283,475,081 had existed between the debtor balance presented by the Corporation and the debtor balances presented by each of the institutions. Particulars are as follows.

Name of the Institution	Balance of the Corporation	Balance according to the Verification of Debtor Balances	Difference
	Rs.	Rs.	Rs.
Bhikku University	35,899,936	47,957,674	12,057,738
Urban Development Authority	165,502,006	62,641,518	102,860,488
Rajarata University	186,960,033	49,392,149	137,567,884
State Development and Construction Corporation	6,866,665	4,838,593	2,028,072
Department of Inland Revenue	66,806,000	37,845,101	28,960,899
Total			283,475,081

2.2.4 Lack of Evidence for Audit

Evidence indicated against the following items of accounts had not been made available to audit.

	Item of Account	Value Rs.	Evidence not Made Available
(a.)	Two bank current accounts	213,835	Verification of balances.
(b.)	Bank account belonging to the Divisions of construction, machinery, and services.	18,693,422	Bank statements as at 31 December 2015.
(c.)	Idle bank account – Nepal	1,880,176	Confirmation of balances, bank reconciliations as at 31 December 2015.
(d.)	Sums payable to the customers of the Service Division.	543,895,470	Detailed schedules.

2.3 Accounts Receivable and Payable

a) Leasing out of the southern section on the seventh floor of the building of the head office of the State Engineering Corporation to the Cement Limited.

The following observations are made.

(i) A lease agreement had been entered into with the Cement Limited on 08 March 2007 in order to lease out the southern section of the seventh floor of the building belonging to the State Engineering Corporation for a period of 02 years from 01 January 2007 to 31 December 2008, but the building had been made use of beyond that period up to June 2015. A lease rent in arrears amounting to Rs. 20,362,650, apart from water and electricity charges amounting to Rs. 3,458,495 had remained receivable in that connection, but no action had adequately been taken to recover those monies.

(ii) Although the space mentioned in the lease agreement entered into with the Lanka Cement Limited had been 2,976 square feet, the Limited had actually occupied an area of 3,175 square feet. As such, an income of Rs. 1,596,878 had remained receivable for the area of 199 square feet occupied additionally with respect to the period from the year 2007 up to 30 June 2015.

(iii) A sum of Rs. 690,610 relating to water and electricity charges that has been remaining outstanding from a date prior to 31 December 2006, has not been recovered so far.

b) Leasing out of the northern section on the seventh floor of the building of the head office of the State Engineering Corporation to the Cement Corporation.
The following observations are made.

(i) Although an agreement had been entered into in order to lease out the northern section on the seventh floor of the building of the head office of the State Engineering Corporation for a period of 03 years from 01 January 2007 to 31 December 2009, the building had been made use of beyond the period of agreement until 31 December 2012. A sum of Rs. 7,609,925 recoverable in that connection had not been recovered up to 08 January 2016.

(ii) Although the area agreed upon had been 2,222.37 square feet, the Lanka Cement Limited had occupied an area of 2,365 square feet. The sum of Rs. 756,722 had not been recovered for the period from the year 2007 up to December 2012 in respect of the area of 142.63 square feet occupied additionally.

c) A balance of special advances amounting to Rs. 5,649,349 had been observed as at 31 December of the year under review, and action had not been taken over a period of more than 03 years to settle a balance of Rs. 5,163,834 included therein.

d) According to the age analysis presented, the creditor balance of 3-5 years amounted to Rs. 15,589,164 whilst the creditor balance of over 5 years amounted to Rs. 348,682,368. Nevertheless, action suitable for settling those balances had not been taken even up to 31 December of the current year.

e) Out of the balance of trade debtors amounting to Rs. 3,455,828,381 existed by the end of the year under review, more than 95 per cent remained receivable from the Government institutions. Out of that, a sum of Rs. 1,074,632,091 equivalent to 33 per cent of the total value, represented the balances older than 05 years.

f) A sum of Rs. 7,444,055 continued to exist over a period of more than 05 years and not specifically recognized as debtors, had been shown as sundry debtors, but action had not been taken either to recognize and recover, or settle those balances.

g) In terms of Financial Regulation 217, payments falling due in any one financial year should be completed before the end of that year as far as possible. However, according to the audit test check, a sum totalling Rs. 98,311,491 relating to a period of 3-5 years, and a sum of Rs. 96,452,897 relating to a period of over 5 years, had not been paid to subcontractors. Furthermore, it was observed that balances totalling Rs. 55,525,662 continued to exist over several years, had been included in the accrual expenses and the balance of other allocations.

h) A sum of Rs. 818,462,729 receivable from Sri Lanka Cricket Institute in respect of 05 projects implemented by the Construction Division and Construction Equipment Division, had remained unrecovered up to 31 December 2015. Furthermore, according to the information revealed during audit, the said receivable value amounted to Rs. 567,601,808 in accordance with the financial statements prepared by the Sri Lanka Cricket Institute as at 31 December 2015.

i) Action had not been taken even after 5 years to settle the payments totalling Rs.248,519,329 made to the subcontractors.

2.4 Non-compliances with Laws, Rules, Regulations, and Management Decisions

The following non-compliances were observed.

Reference to Laws, Rules, and Regulations, etc.		Non-compliance
(a.)	Value Added Tax Act, No. 14 of 2002	Action had not been taken to pay value added tax totalling Rs. 88,165,979 relating to the year 2015.
(b.)	Section 114 of the Inland Revenue Act, No. 10 of 2006.	PAYE tax totalling Rs. 132,959 payable on bonus, had not been paid.
(c.)	Section 02 of the Economic Service Charges Amendment Act, No. 13 of 2006.	The institutions generating an income greater than Rs. 50 million per quarter, should pay an economic service charge equivalent to 0.25 per cent of the income not exceeding Rs. 30 million per quarter. However, the economic service charges amounting to Rs. 7,920,041 payable as per the computations of the audit in respect of the income earned by the Corporation in the year 2015 amounting to Rs. 3,168,016,408, had not been taken action to paid.

(d.)	Financial Regulations of the Democratic Socialist Republic of Sri Lanka.	
	(i) Financial Regulation 396 (d)	Action had not been taken in terms of Financial Regulations on 28 cheques valued at Rs. 1,524,787 that had remained over a period of over 06 months as at 31 December 2015 since the date of issue.
(e.)	Section 3 of the Circular, No. 02/2015 of the Department of Management Services, dated 09 December 2015.	Although the accounts had not been furnished to the Auditor General on time in terms of the Circular, a sum of Rs. 8,421,000 had been paid to 2,492 employees as bonus.
(f.)	Management Audit Circular, No. DMA/2009(2), dated 01 July 2009.	Information had not been included in the Register of Fixed Assets in terms of the Circular.
(g.)	Treasury Circular, No. IAI/2002/02, dated 28 November 2002.	A Register of Fixed Assets had not been separately maintained for computer accessories and software.
(h.)	Employees' Provident Fund, No. 15 of 1958, and Employees' Trust Fund, No. 46 of 1980.	As contributions to the Employees' Provident Fund and the Employees' Trust Fund had been paid irrespective of the cost of living allowance from the year 2006 up to the year 2014, a sum totalling Rs. 184.7 million, and the contribution of the Corporation for the year under review had been remitted in deficit of sums amounting to Rs. 21,336,900 and Rs. 5,334,225 respectively.
(i.)	Section 2(c) of the Circular, No. 121/1979 issued by the Chairman of the State Engineering Corporation of Sri Lanka dated 20 December 1979.	Once the advances are given in cheques together with the orders, such advances should be settled within a period of 30 days. However, the advances of Rs. 68,191,290 given had remained unsettled over a period of more than 03 years.

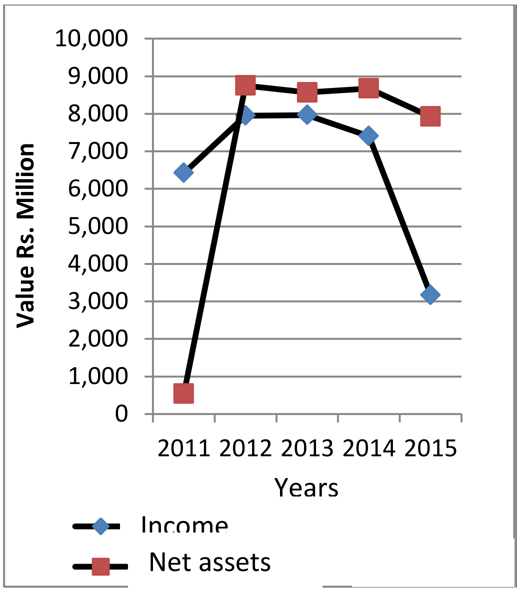
3. Financial Review

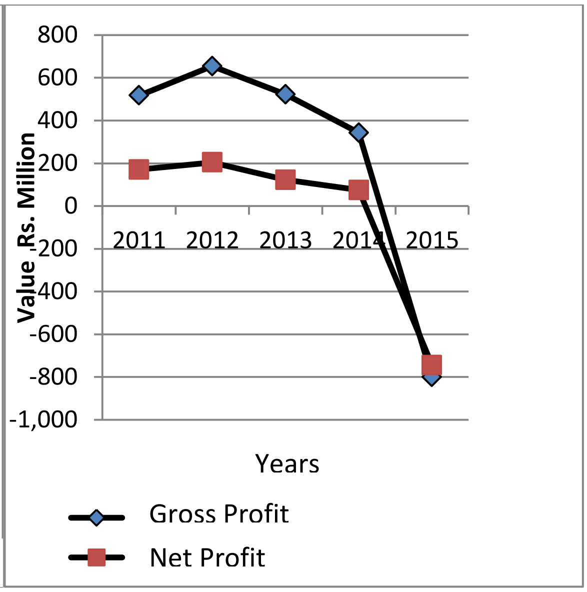
3.1 Financial Results

The financial result of the Corporation for the year under review had been a net loss of Rs. 744,581,777, as opposed to the net profit for the preceding year amounting to Rs. 74,534,988, thus indicating a deterioration in the net profit by a sum of Rs.819,116,765 as compared with the preceding year. The decrease in the income by a sum of Rs. 4,235,402,252 as compared with the preceding year, had mainly attributed to the said deterioration.

An analysis on the financial results of the year under review and 4 preceding years revealed that a financial surplus had resulted from the year 2011, but the said surplus had gradually deteriorated from the year 2012 up to the year 2014. As such, the surplus of the year 2011 amounting to Rs. 206,152,011 had become a deficit of Rs.744,581,777 by the end of the year under review. Furthermore, after the employee remuneration, Government taxes, and depreciation on non-current assets, had been adjusted to the financial result, the contribution of the year 2011 being a positive value of Rs. 589,687,734, had reached a minus value of Rs. 218,214,484 by the end of the year under review.

The income, net assets, gross profit, and the net profit of the Corporation for the 04 preceding years are illustrated in the following diagrams.





3.2 Analytical Financial Review

(a.) Some of the significant accounting ratios prepared for the year under review based on the information presented to audit, are as follows.

Accounting Ratio	2014	2015
	(Per cent)	(Per cent)
Gross Profit Ratio	2.63	(25.23)
Net Profit Ratio	0.63	(22.37)
Administrative Expenditure on Turnover	5.24	8.64
Net Financial Expenditure on Turnover	0.81	1.96
Current Ratio	1.04	0.98
Quick Ratio	0.99	0.92

The following observations are made in this connection.

(i) As compared with the preceding year, the gross profit ratio had deteriorated by 1059 per cent whilst the net profit ratio had deteriorated by 3650 per cent.

(ii) The administrative expenditure on turnover had increased by 65 per cent whilst the net financial expenditure had increased by 142 per cent as compared with the preceding year.

(iii) As compared with the preceding year, the current ratio had decreased from 1.04 to 0.98 whilst the quick ratio had decreased from 0.99 to 0.92.

(iv) Considering the total cost of sales of the Corporation for the year under review as a percentage of the income, the value had increased from 97 per cent to 125 per cent as compared with the preceding year.

(b.) The analysis on the financial result of the year under review and 04 preceding years indicates that the post-tax net profit of the Corporation had continuously decreased from the year 2011, and being compared with the preceding year, the said value had decreased by 1,098 per cent in the year under review.

(c.) As compared with the preceding year, the total turnover and the pre-tax net profit of the year under review had deteriorated by 57 per cent and 1,621 per cent respectively.

(d.) The income of the year under review had been Rs. 3,168,016,408, and as compared with the preceding year, the income had deteriorated by a sum of Rs. 4,235,402,252 representing 57 per cent.

(e.) The total expenditure incurred during the year under review in respect of salaries, wages and allowances, contract labour, and other expenses relating thereto, had amounted to Rs. 1,753,310,158 representing 44 per cent of the total cost.

(f.) The labour cost as a percentage of the total cost in respect of the Construction Division, Construction Component Division, M & E Division, the Consultancy Division, and the E & M Division had been 46 per cent, 35 per cent, 51 per cent, 92 per cent, and 57 per cent respectively.

(g.) As costs had been incurred in excess of the contract value, it was observed that the cumulative loss incurred on 52 projects in the year 2015 totalled Rs.803,367,009.

(h.) Losses had been incurred from the year 2013 up to the year under review in respect of 06 sites belonging to the Construction Division, and that loss amounted to Rs. 61,745,058 as at 31 December 2015

4. <u>Operating Review</u>

4.1 <u>Performance</u>

The main objectives mentioned in the State Industrial Corporation Act, No. 49 of 1957 had been amended as follows by the Minister in charge in terms of Section 3 (2) of the said Act through the Gazette No. 1543 of the Democratic Socialist Republic of Sri Lanka, dated 28 March 2008.

(i) The investigation, planning, designing and construction of building, civil engineering and other engineering projects in Sri Lanka or abroad, owned by any party, either independently or in collaboration with any local or foreign company and the acquisition and holding of shares, in any such company.

(ii) The provision of consultancy and project management services in all fields of engineering in Sri Lanka or abroad, to any party, either independently or in collaboration with any local or foreign company and the acquisition and holding of shares, in any such company.

(iii) To undertake property development either independently or in collaboration with any local or foreign company and the acquisition and holding of shares, in any such company.

(iv) The manufacture and sale in Sri Lanka or abroad of ready mix concrete, reinforced concrete and pre-stressed concrete products.

(v) The manufacture, sale, import and export of construction materials, machinery and equipment required for engineering projects/undertakings.

(vi) The training of engineering and technical personnel required for the purposes referred to in Paragraphs (i), (ii), (iii), (iv) and (v).

(vii) The carrying out of research into construction materials, methods and techniques utilized for the purposes referred to in paragraphs (i), (ii), (iii) and (iv).

The following observations are made on the achievement of the said objectives.

(a.) <u>Construction Division</u>

(i) <u>Aluminium Factory, Ratmalana (Site No. 6001)</u>

The income of the said Aluminium Factory pertaining to the Construction Division had decreased by 62 per cent in the year under review as compared with the year 2014, whilst the operating loss of the preceding year amounting to Rs. 1.79 million had deteriorated to a loss of Rs. 4.18 million by 133 per cent. The unusual increase in the labour expenditure of the subcontracts as compared with the preceding year, had mainly attributed to this situation.

(ii) <u>Machinery Rental Site, Maligawatta (Site No. 828)</u>

The income of the Machinery Rental Site, Maligawatta had deteriorated by 84 per cent as compared with the preceding year whilst the operating loss of the preceding year amounting to Rs. 0.22 million had deteriorated to Rs. 4.95 million in the year under review.

(b.) Construction Component Division

(i) Precast Yard, Ratmalana (Site No. 343)

The operating profit of this yard for the preceding year amounting to Rs. 3.51 million had become an operating loss of Rs. 33.67 million in the year under review. As compared with the preceding year, the deterioration in the income by 49 per cent, and the increase in the expenditure other than the cost of sales, by 12 per cent had been observed to have attributed to this situation.

(ii) Bricks and Carpentry Products Yard, Dankotuwa (Site No. 1099)

The operating loss for the preceding year amounting to Rs. 4.3 million of this yard that had sustained losses throughout 17 years out of the 18 preceding years, had become a loss of Rs. 8.25 million after being deteriorated by 92 per cent in the year under review. Moreover, the income of the year under review had deteriorated by 38 per cent as compared with the preceding year, but other expenditure except for the cost of sales, had increased by 68 per cent.

(iii) Precast Yard, Peliyagoda (Site No. 1168)

Due to failure in preparing the ground with proper management in the implementation of C-City project, it was revealed that the precast products valued at Rs. 12,397,200 lain at the yard had been destroyed, thus causing a loss of Rs. 12.4 million in the year under review.

(iv) Precast Yard – Welikanda (Site No. 1738)

A loss of Rs. 1.37 million had been incurred in the year under review by this yard that had generated an operational profit of Rs. one million in the preceding year. It was revealed that the increase in the cost of sales, and the other expenditure had attributed to this situation.

(v) Concrete Sleepers Yard (Site No. 1510)

This yard had generated an operating profit of Rs. 43.27 million in the preceding year but the operating profit had deteriorated to Rs. 25.42 million in the year under review. This situation had mainly been attributed by the decrease in the income of the yard by 22 per cent.

(c.) Mechanical and Electrical Division

(i) Operating Yard, Peliyagoda (Site No. 102)

The operating losses of the said yard amounted to Rs. 1.65 million, Rs.3.86 million, and Rs. 23.5 million in the years 2013, 2014 and the year under review respectively, thus observing that the operating loss had continuously deteriorated. The continuous and exponential decrease in the sales income had directly attributed to this situation.

(ii) Operating Yard, Peliyagoda (Site No. 104)

This yard had generated an operating profit of Rs. 7.43 million in the year 2013, but deteriorated to losses of Rs. 1.33 million, and Rs. 35.14 million in the year 2014, and the year under review respectively. This situation had been caused by the exponential decrease in the sales income, and the increase in the cost of sales.

(iii) Dolomite Processing Plant, Matale (Site No. 1100)

The review on the operations of the said Plant reviewed that, during the 17 preceding years, the Plant had been maintained with losses throughout all the years except for the year 2006. The operating loss of Rs. 4.29 million in the year 2014 had deteriorated to Rs. 10.23 million by 139 per cent in the year under review, and the exponential decrease in the sales income had directly attributed thereto.

(iv) Ratmalana Yard (Site No. 888)

This yard had sustained an operating loss of Rs. 23.95 million in the year under review. This situation had been caused by the decrease in the income of the preceding year amounting to Rs. 30.82 million to Rs.5.75 million, and the increase in the cost of sales and other expenditure.

(d.) Special Operations Division

Asphalt Plant, Galapatha (Site No. 1843)

Production had been commenced at this Plant on 01 August 2013, and discontinued after 31 December 2015 indicating that the production process had been limited only to 64 working days. As the employees attached had further been retained at the Plant, and salaries had been paid despite the production had been halted, the loss of the preceding year amounting to Rs.3.7 million had increased to Rs. 15.53 million in the year under review. A cumulative loss of Rs. 24.03 million had incurred by the end of the year under review.

(e.) Machinery Division

The following observations are made.

(i) Of the 23 yards and regional offices including the main stores in Kolonnawa of the Machinery Division, none had generated profits in the year under review, and the cumulative loss sustained by the end of the year amounted to Rs. 177.73 million.

(ii) The cumulative profit of Rs. 14.04 million generated by the regional offices in Vauniya, Kurunegala, Kuliyapitiya, and Anamaduwa, in the preceding year, had decreased to a loss of Rs. 23.88 million in the year under review.

(iii) The yards at the main stores in Kolonnawa, regional offices in Horana, Kundasale, Ampara , Kalmunai and Thamankaduwa, and Kegalle depot, had not generated any income whatsoever in the preceding year and the year under review as well. But, an expenditure of Rs. 26.84 million had been incurred during the year under review in terms of salaries, wages, electricity, telephone, fuel and other expenses.

(iv) Although a cost of Rs. 1,065,550 had been incurred on 03 yards pertaining to the Construction, and M & E Divisions, no progress whatsoever had been indicated from the year 2014 up to the end of the year under review.

4.2 Management Activities

The limit of the bank overdrafts for the Corporation amounted to Rs. 353.7 million as at the end of the period, but overdrafts amounting to Rs. 78 million had been obtained in excess of that limit by the end of the year under review.

4.3 Transactions of Contentious Nature

The following observations are made.

(a.) Sums of Rs. 608,474 and Rs. 182,950 had been paid as Value Added Tax in the years 2014 and 2015 respectively to 09 suppliers whose registration for Value Added Tax with the Department of Inland Revenue had been cancelled.

(b.) In terms of Sections a (VI) and (XVIII) of Part II of Schedule 1 of the Value Added Tax Act, No. 14 of 2002 of the Department of Inland Revenue, diesel and bitumen had been exempted from taxes, but a sum of Rs. 4,752,280 had been paid as Value Added Tax on the invoices of the suppliers.

4.4 Uneconomic Transactions

(a.) Obtaining a land on lease for establishing the Asphalt Plant in Elpitiya.

The following observations are made.

(i) Without conducting a feasibility study and obtaining permission from the Central Environmental Authority for the implementation of the project, taxes amounting to Rs. 3,000,000 had been paid at once on 07 September 2012 for a period of 05 years at Rs. 50,000 per month though the Board of Directors Paper No. 780/53. Nevertheless, this project had been halted at the initial stage itself.

(ii) A written approval had been obtained by the owner of the land to maintain a rock quarry at the land for a period of one year from February 2012. Despite being informed by the CATIC institution (China National Aero Technology Import & Export Corporation) in the year 2012 that the said land would not be suitable for manufacturing asphalt, a sum of Rs. 1,515,524 had been incurred as other expenses relating to the implementation of the project.

(b.) Asphalt and Crusher Machinery site, Galpatha

The following observations are made.

(i) Advances had been given to the suppliers in the year under review for the supply of raw material, but raw material had not been supplied for a sum totalling Rs. 29,642,269.

(ii) A rental of Rs. 1,800,000 had been paid for a period of 02 years up to 25 December 2016 in respect of this project, but manufacturing had continued only for 03 days producing only 279.36 tons of asphalt. The cumulative loss thereof amounted to Rs. 25,580,485 in the year under review.

4.5 Identified Losses

The following observations are made.

(a.) Since the payments of retirement gratuity had not been made within the prescribed period, a sum of Rs. 255,567 had been paid to 03 employees by the Corporation as surcharges.

(b.) Fifty two contracts had been awarded for the construction of roads in Ratnapura district in the year 2011, and a sum of Rs. 53,198,183 had been paid to the contractors in excess of the contract value relating to 26 contracts. Five of those projects had been halted at the inception itself, and no action had been taken to recover the mobilization advance amounting to Rs. 36,385,693 paid thereon.

4.6 Resources of the Corporation Released to Other Government Institutions

The following observations are made.

(a.) Contrary to Section 8.3.9 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003, twenty nine employees of the Corporation had been released to the Line Ministry without approval of the Board of Directors. As the salaries of those employees, a total of Rs. 36,442,355 had been paid by the Corporation including sums of Rs. 31,638,155, and Rs. 4,804,200 relating to the periods from 2011 up to the end of 2015, and January-May 2016 respectively.

(b.) Two casual employees had been released to the Line Ministry without approval of the Board of Directors, and it was observed that salaries totalling Rs. 698,580 had been paid with respect to the period from 01 January 2016 up to 31 October 2016.

(c.) Five of the casual and unskilled employees recruited on daily wages had been released to the Line Ministry without approval of the Board of Directors. Salary advances totalling Rs. 500,000 had been paid to them relating to the period 01 January 2016 – 30 June 2016 without computing the salaries payable to those employees.

4.7 Procurement and Contract Procedure

The following observations are made.

(a.) Inspection on the housing projects - Kalinga Mawatha

In terms of the Letter No. 12/1165/503/083 of the Minister of Finance and Planning, the Urban Development Authority had awarded this contract to the Corporation for the construction of 816 units of houses, but both parties had later agreed to construct only 648 units of houses. Although it was expected to implement this project under 02 stages, and complete the first stage by 19 December 2015, the project had been halted after 04 June 2015.

(b.) The construction of the project implemented under stage 02 had been commenced on 21 April 2014, and it was expected to complete by 21 October 2016, but the project had been halted by 31 December 2015.

(c.) Contrary to Guideline 5.4.4 (1) of the Government Procurement Guidelines, it was observed that mobilization advances amounting to Rs. 4,803,492 had been given in excess of 20 per cent of the contract value.

(d.) The contract period of 02 sub contracts with the contract value of Rs. 83.5 million had elapsed by 19 March 2015, but the physical progress thereof had remained low. Mobilization advances amounting to Rs. 3.9 million given to those contractors had not been recovered, and although the period of validity of the advance bonds valued at Rs. 4. 2 million furnished by the contractors had elapsed, action had not been taken to extend the period.

(e.) Due to improper financial control of the Corporation, and failure to make payments to the sub-contractors properly, action had been taken by the Urban Development Authority to take over the two housing projects progressing on the Kalinga Mawatha at a contract value of Rs. 1,704,907,440 of which the physical progress of construction had remained extremely low.

(f.) Mobilization advances totalling Rs. 27,596,156 had been obtained in the year 2010 from the clients, and instances were observed in which no service whatsoever had been provided so far in that connection.

4.8 Staff Administration

The following observations are made.

(a.) As compared with the approved cadre of the Corporation, 559 employees of 101 posts in the entire staff remained vacant as at 31 December 2015 including 65 officers relating to 21 posts in the senior management level, and 139 officers relating to 39 posts in the tertiary management level.

(b.) In order to make recruitments to most of the posts in the senior management level on permanent basis, the approval of the Department of Management Services had been received by the Corporation in the years 2009 and 2011, but 6 officers had been appointed on contract basis for 06 posts in the senior management level under higher salary scales.

(c.) An appointment should be made only for a post in the approved cadre in terms of Section 1.2 of Chapter II of the Establishments Code. Nevertheless, 451 excessive employees had been appointed for 41 posts in excess of the approved cadre as at 31 December 2015.

(d.) In terms of the Management Services Circular, No. 28 (ii), dated 01 August 2006, and the letter No. DMS/E3/43/4/265/1 of the Director General of the Department of Management Services, dated 25 November 2009, it had been informed that vacancies should not be filled, nor should new posts be created without approval of the Department of Management Services. Nevertheless, of the 451 aforesaid excessive employees for whom the approval of the Department of Management Services had not been granted, 16 employees had been appointed to 13 unapproved posts. Making permanent of the appointments of the employees appointed to 07 posts therefrom had been questionable in audit.

(e.) Despite the 99 excessive unskilled employees as at 31 December 2015, it was observed that 300 casual and unskilled employees had been recruited during the period 01 January 2016 – 31 October 2016 on the basis of daily wages without approval of the Board of Directors and the Department of Management Services paying salaries totalling Rs. 74,107,520.

(f.) A Committee had been appointed by the Chairman to provide relief for the aggrieved employees without approval of the Board of Directors. Two, out of the 3 members thereof had been the officers employed at the Corporation (Deputy General Manager Human Resources and Administration, and Legal Officer), and as such, it was not possible to satisfy in audit as to the independence and impartiality of the recommendations presented.

Furthermore, the recommendations provided by the said Committee contrary to the provisions of the Establishments Code, are as follows.

(i) In terms of Section 1.10 of Chapter II of the Establishments Code, the Appointing Authority should not ante-date an appointment on any grounds without the authority of the Director of Establishments. Nevertheless, 03 officers in the posts of Management Assistant, Administrative Officer, and Accountant, had been ante-dated by 07, 06, and 2 1/2 years respectively and appointments had been granted.

Furthermore, a sum of Rs. 948,175 as salaries in arrears with respect to the new posts with effect from the antedated date, along with the salaries for a period of over one year during which their service had remained suspended, had been paid without approval of the Board of Directors

(ii) Furthermore, in terms of Sections 1.11 and 1.11.1 of Chapter II of the Establishments Code, ante-dating will not be allowed if such ante-dating results in the officer concerned gaining seniority over an officer appointed before him to the same grade or post. However, as the appointment to the post of Administrative Officer had been ante-dated, it was observed that the Corporation had violated the provisions in the said Sections. Hence, in accordance with the aforesaid observations, it was revealed that the Committee of investigation had furnished recommendations to the Board of Directors by violating the provisions in the Sections 1.10, 1.10.2, 1.11, & 1.11.1 of Chapter II of the Establishments Code.

(g.) The following observations are made in respect of the acting appointments of the Corporation.

(i) Without taking action to recruit officers for the posts in the top and middle level management of the State Engineering Corporation of Sri Lanka, 12 officers had been appointed on acting basis in the year 2015.

(ii) In terms of Section 13.3 of Chapter II of the Establishments Code, it is the responsibility of the institution to make substantive appointments for the acting appointments without delay. However, many of the said officers had been performing the duties in acting posts over periods ranging from 01 to 11 years, and the Corporation had failed even up to 12 August 2016 to make substantive appointments for those posts.

(iii) An officer in the permanent post of Senior Engineer of the Corporation had been attached to the posts of Acting Deputy General Manager of the Construction Equipment Division, and the Acting Manager, thus the management of the Corporation had not drawn its attention on the working capacity of the said officer.

(iv) In terms of Section 12.2.6 of Chapter VII of the Establishments Code, approval of the Secretary to the relevant Ministry should be obtained for paying the acting salaries. However, such an approval had not been obtained for paying the acting salaries of the Corporation.

5. <u>Accountability and Good Governance</u>

5.1 <u>Presentation of Financial Statements</u>

In terms of Section 6.5.1 of the Public Enterprises Circular, No. PED/12 dated 02 June 2003, the annual financial statements and the draft report should be furnished to the Auditor General within 60 days from the close of the year of accounts. Nevertheless, financial statements pertaining to the year under review had been furnished to the Auditor General on 17 May 2017, after a delay of 436 days.

5.2 Corporate Plan

Although a Corporate Plan had been prepared for the period 2012-2015 in terms of the Public Enterprises Circular, No. PED/12, dated 02 June 2003, the Plan had not been updated in respect of the year under review.

5.3 Action Plan

The Corporation had not prepared an Action Plan for the year under review in terms of Public Finance Circular, No. 01/2014, dated 17 February 2014.

5.4 Budgetary Control

As significant variances ranging from 46 per cent to 70 per cent were observed between the budgeted and the actual income and expenditure, the budget had not been made use of as an effective instrument in Management Control.

5.5 Tabling of Annual Reports

The Corporation had not tabled the Annual Report for the year 2014 in Parliament even up to 30 June 2017 in terms of Section 6.5.3 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003.

5.6 Unresolved Audit Paragraphs.

(a.) The Institute of Construction Training and Development had constructed a technology park and low cost housing models by incurring a sum of Rs. 36 million on a land of 2.5 acres in Peliyagoda belonging to the Corporation. The constructions thereof had been carried out by the Corporation, and a sum of Rs. 2.2 million had remained receivable to the Corporation in that connection. Although a sum of Rs. 1.2 million had been spent on the security service of the site relating to the period 2014-2015, it had not been utilized productively.

(b.) It was expected to commence the C-City project, Peliyagoda on 06 July 2013, and complete by 31 January 2014, but even by 03 September 2015, the project had not been completed but halted. The sum incurred by the Corporation as at 31 December 2014 amounted to Rs. 463 million, and of the 18 items of work shown in the BOQ, no progress whatsoever was observed relating to the construction of 12 items of work.

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.

Areas of Systems and Controls		Observation	
(a.)	Accounting	(i)	Failure to follow the Sri Lanka Accounting Standards.
		(ii)	Failure to account the taxes payable and the surcharges thereon.
		(iii)	Failure to compare the Control Accounts.
		(iv)	Failure to present the financial statements on the specified dates.
(b.)	Financial Control	(i)	Granting advances through cheques with the orders.
		(ii)	Non-recovery of funds from the debtors brought forward over many years. Control of debtors remained weak.
		(iii)	Significant delays in presenting the invoices for the relevant clients.
		(iv)	Existence of purchase advances over a long time without being settled.
		(v)	Failure to settle the long term retention money relating to constructions.
(c.)	Trade and other Amounts Payable	(i)	Existence of mobilization advances over a long period of time without being settled.
		(ii)	Payment of surcharges due to failure in paying taxes on time.
(d.)	Staff Administration	(i)	Releasing human resources to other institutions.
		(ii)	Recruiting employees in excess of the approved cadre.
		(iii)	Recruiting officers to the senior management on contract basis.
(e.)	Assets Management	(i)	Failure to take action to properly utilize the idle assets.
		(ii)	Failure to take over the ownership of lands.
(f.)	Control of Stocks		Failure to conduct annual surveys at all sites.