

1.1 Qualified Opinion

The audit of the financial statements of the National Building Research Organization for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and statement of financial performance, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies 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 provisions of the National Audit Act No. 19 of 2018 and Finance Act No. 38 of 1971. My comments and observation which I consider should be reported to the Parliament appear in this report.

In my opinion, except for the effects of the matters described in the paragraph 1.5 of this report, the accompanying financial statements give a true and fair view of the financial position of the National Building Research Organization as at 31 December 2018, and of its financial performance and its cash flows for the year then ended were prepared in accordance with Sri Lanka Public Sector Accounting Standards.

1.2 Basis for Qualified Opinion

My opinion is qualified on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the National Building Research Organization’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the National Building Research Organization or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the National Building Research Organization’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, it is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared.

1.4 Audit Scope

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Organization's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities and whether such systems, procedures, books, records and other documents are in effective operation,
- Whether the National Building Research Organization has complied with applicable written law, or other general or special directions issued by the governing body of the National Building Research Organization,
- Whether the National Research Organization has performed according to its powers, functions and duties, and
- Whether the resources had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Internal Control over the Preparation of Financial Statements

Entities are required to “devise and maintain” a system of internal accounting controls sufficient to provide reasonable assurance that transactions are executed in accordance with management’s general or specific authorization, transactions are recorded as necessary to permit preparation of financial statements in conformity with the applicable reporting standards, and to maintain accountability for assets, access to assets is permitted only in accordance with management’s general or specific authorization, and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

1.5.2 Accounting Deficiencies

The following observations are made.

Audit Observation	Comments of the Management	Recommendation
(a) Eventhough a sum of Rs 11.01 million was required to be provided for the payment of retirement gratuity as at 31 December 2018, only a sum of Rs 8.39 million had been provided.	The respective error was made at time of passing journal entries and action will be taken to rectify it in preparation of financial statement in 2019.	The liabilities existed at the end of the year under review is needed to be taken into account to ensure the accuracy of the financial statements.

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| (b) | Retention money amounting to Rs 8.09 million made on construction of a new office building had been set off against the amount paid to the contractor, as a result, the value of civil work in progress had been understated by that amount. | Action will be taken to rectify the error at the time of preparation of financial statement in 2019. | The value of works certified as at 31 December 2018 is required to be accounted as the value of work-in-progress |
| (c) | A sum of Rs. 1.01 million remitted by the District Offices of the Research Organization had been shown in the financial statement under unidentified receipts. | Instruction had been issued by the Research Organization to the Banks to record the application number mentioned in the deposit slip . However, it was not done in the several instances and as a result, this situation was arisen. | A mechanism is needed to be established to identify the direct remittances made to the Bank Accounts of the Research Organization. |
| (d) | Action had not been taken to settle the balances aggregating Rs 1.43 million shown as excess receipts from the customers as at 31 December 2018.It included the balances aggregating Rs 1.23 million remained unsettle over a year. | Action will be taken to bring these balances into income in 2019. | A mechanism should be established to settle the balances. |

1.5.3 Inappropriate Evaluation or Estimation

Audit Observation	Comments of the Management	Recommendation
(a) Eventhough the Engineer's Estimate for the works on landslide mitigation project at the premises of Kadugannawa Tamil Maha Vidyalaya amounted to Rs 25.23 million, the contract had been awarded at a cost of Rs 29.50 million. The contract had been awarded at a higher value of 17 per cent of the estimated cost , due to the shortcomings of the Engineer's Estimate.	All the contractors had submitted their bids on costs on reconstructions, premises and concrete works over the Engineer's Estimate , due to the practical difficulties prevailed at the work site of Kadugannawa Tamil Maha Vidyalaya. Therefore, considering the respective practical difficulties , the contract had been awarded to the contractor who submitted to lowest bid, according to the Government Procurement Guidelines	These shortcomings can be rectified by preparing of estimates in accurate manner.

- (b) The Geo Technical and Engineering Division of the Research Organization had undertaken a consultancy contract to prepare the engineering plans for a project implemented to mitigate river side erosion at Thoppwa Bridge in Kochchikade, Negombo and charged a fees amounting Rs 10.96 million. However, the actual cost thereon amounted to Rs.6.85 million thereon. It was observed that a profit margin of Rs.4.12 million had been retained by the Geo Technical and Engineering Division on the allocation made by the General Treasury through overestimation of costs.
- The salary rates applied to deploy professionals essential to continue the operations of other similar project implemented by the Research Organization had been used for this purpose as well. As pointed out in the audit report, action will be taken to adjust the consultancy fees in 2019.
- It is need to be considered to apply a profit margins in fair manner in providing consultancy services for the government projects.
- (c) An allocation amounting to Rs 31 million had been made by the General Treasury in 2018 on a request made by the Research Organization to install 30 units of automated rain gages. However, the value of Engineering Estimation prepared thereon by the Research Organization only amounted to Rs 17.30 million whilst awarding of the contract at a cost of Rs. 12.85 million. Therefore, the allocation amounting to Rs 18.15 million had been requested excessively due to preparation of estimates without being carried out proper studies . Further, the locations to install the rain gages had not been identified even as at 31 December 2018
- The bids had been received from a single entity to produce and install automated rain gages prior to 2016. Thereafter, the technology had been transferred widely and increased the number of producers, as a result, the several competitive bids were received. Therefore, the price of the equipment had been declined remarkably. Action had been taken to install the additional 15 rain gages by using extra allocations. All the rain gages had been installed as present.
- The allocation of funds can be effectively utilized for the intended purposes by evaluating all the environmental factors fairly, at the time of preparation of Estimates.

1.5.4 Lack of Documentary Evidence for Audit

The following observation is made.

Subject	Amount Rs.million	Audit Evidence not made available	Comments of the Management	Recommendation
Use of funds allocated to implement landslide risk mitigation project for other purposes	16.81	Approval of the General Treasury	The approval of the General treasury had been sought on the respective transaction and the reminders thereon had been made.	Prior approval is required to be made to utilize the allocation.

1.6 Accounts Receivables and Payables

1.6.1 Receivables

The following observations are made.

Audit Observation	Comments of the Management	Recommendation
(a) The contractors who undertook civil construction contracts on land slide mitigation projects implemented at the premises of Pussala Navodha Vidyalaya and Wewegama Hospital at Badulla had abandoned the works on contracts since April 2016. However, action had not been taken to recover the advances taken by the contractors amounting to Rs.1.66 million through the performance bonds valued at Rs. 1.57 million made thereon.	At the time of termination of the contract activities, the works equals to the value of advanced had been completed by the contractor. Eventhough the requests had been made to release the performance bonds, action had not been taken by the Insurance Company thereon. Thereafter, the accepting of performance bond from Insurance Companies had been ceased.	Action should be taken to contract supervision activities in proper and continuous manner. Further, the performance bond should be accepted from the Licensed Commercial Banks only, as per circular instructions.
(b) Eventhough a sum of Rs. 5.92 million had been continuously shown in the financial statements of the Research Organization since 2009, as a balance receivable from the Urban Development Authority, it was observed that the respective balance had not been shown as a payable in the financial statements of the Authority	The requests had been made to the Ministry of Sports, Urban Development Authority and General Treasury through the Secretary of the Line Ministry and several rounds of discussion had been made to recover the dues. The actions are still being taken in this regard, eventhough it was not in success yet.	As it is a state owned entity, action should be taken to come to an agreement to settle the dispute..

1.6.2 Advances

The following observation is made.

Audit Observation	Comments of the Management	Recommendation
Eventhough the works under the 22 construction contracts on landslide mitigation purposes awarded by the Research Organization during the period from 2015-2017 had been	Action had been taken in 2019 to recover all the advances, as the contracts awarded since 2017 upto 2017 had been completed.	This risk had been arisen due to lack of action taken to recover the advances from the interim payments. Therefore action should be taken to identify all the responsible

completed , the advances aggregating Rs 75.43 million made to the contractors had not recovered even at the end of the year under review.

parties and minimise the risks on probable losses in this regard.

1.7 Non- Compliance with Laws, Rules Regulations and Management Decisions

The following observation is made.

References to Laws, Rules and Regulations	Non- Compliance	Comments of the Management	Recommendation
Financial Regulation 835(2)(b)	A sum of Rs. 9.39 million had been spent during the year under review to obtain buildings on rent basis to operate 10 District Offices of the Research Organisation. However, the Assessment Reports had not been obtained thereon from the Chief Valuer.	Action will be taken in future to obtain the Assessment Reports from the Chief Valuer in accordance with the Financial Regulation 835(2)(b)	It is necessary to obtain the Assessment reports from the Chief Valuer and amend the building rent accordingly.

2. Financial Review

2.1 Financial Result

According to the financial statements, the operating result for the year under review was a surplus of Rs.63.68 million and the corresponding surplus of the previous year amounted to Rs. 43.83 million. Thus, it indicated that there was an improvement of the operating results of the Research Organization by Rs. 19.85 million. The increase of the interest on fixed deposits was the main reason for the respective improvement.

2.2 Trend Analysis of Major Sources of Income and Expenditure

The operating result of each Division of the Research Organization for the year under review compared with the previous year are described in the table under mentioned.

Division	Operating result as at		Increase/ (Decrease) of the Operating Result Rs.	Percentage
	2018 Rs.	31 December 2017 Rs.		
Environmental Studies and Services	15,047,412	12,947,606	2,099,806	16
Geo Technical and Engineering	8,894,222	1,149,561	7,744,661	674
Project Management	2,331,376	3,322,257	(990,881)	(30)
Landslide Research and Risk Management	348,249	11,746,814	(11,398,565)	(97)
Human Settlement Planning and Research	11,198,228	2,879,675	8,318,553	289
Building Materials Testing	6,140,146	9,697,689	(3,557,543)	(37)

According to the above mentioned information, the Divisions which reported surpluses except the Building Materials Testing Divisions are operated under self-financing basis. It was observed that other Divisions which implemented projects under the financial allocations made by the General Treasury had incurred expenses exceeding the income generated.

3. Operational Review

3.1 Management Inefficiencies

Audit Observation	Comments of the Management	Recommendation
(a) The Cabinet Memorandum presented to pass a parliamentary bill to ensure the legality of the Research Organization had been approved on 02 June 2010 and the draft thereon had been submitted to the Legal Draftsman Department on 10 September 2012. However, respective Act had not been passed by the parliament even as at 31 December 2018.	The final draft of the proposed Act to establish the Research Institute had been sent back by the Legal Draftsman Department after making necessary amendments and submitted it to the Attorney General's Department and the Ministry of Finance for their comments.	The contribution of the Research Organization would be fruitful after being established it as a constitutional institute to mitigate the landslide risk which is the major risk faced by Sri Lanka. Therefore, actions should be taken immediately to pass the bill.
(b) The action had been taken to obtain buildings for Project Offices on rent without considering the availability of additional spaces in the building of District Offices of the Research Organization located at Ratnapura,	The buildings for District Offices had been hired considering the administrative requirements. The matters such as the close proximity to the construction site and possibility	Action should be taken to minimize the additional costs.

Kegalle and Kandy. A sum of Rs 1.16 million had been spent during the year under review thereon.

to provide accommodation facilities had been considered for hiring of buildings to establish Project Offices. The action had been taken to establish Project Officers at the premises of District Offices.

3.2 Operating Inefficiencies

The following observations are made.

Audit Observation	Comments of the Management	Recommendation
(a) The activities under the landslide mitigation Project implemented at the Stelinburgh Estate in Doluwa Divisional Secretariat area in Kandy district had been suspended due to difficulties in finding access roads and instead of that the landslide mitigation Project at Kadugannawa Tamil School had been implemented. Therefore, it was observed that the selection of mitigation projects had not been done in a priority basis and implemented such projects at the locations with adequate access facilities.	According to our experience, when a bid called for the projects with difficulties faced to access the construction site, either bidders would not submit the bids or apply higher rates for the bids submitted. Further, in some instances, the bidder who quoted lowest price may suspend the construction works halfway. The priority had been given to select the landslide mitigation project at the Kadugannawa Tamil School considering the risk faced by the students in the school due to poor condition of the buildings and the requests made thereon.	The land slide mitigation projects should be implemented in priority basis and minimise the risks thereon.
(b) A sum of Rs.8.35 million had been spent to implement 03 landslide mitigation projects at Kendawa, Dharmaraja Perivena and Deensite Estate in Kandy district which were not included in the Annual Action Plan.	These parts had been included in the initial plans and decided to postpone due to shortages of the technical knowledge and experienced staff. Therefore, the respective activities had been implemented in this year. The landslide mitigation project at the Dharmaraja Perivena had been implemented on a request made by the District Secretary.	Action should be taken to identify the requirements on priority basis at the time of preparing the Action Plan.

3.3 Underutilization of Funds

The following observation is made.

Audit observation	Comments of the Management	Recommendation
A sum of Rs 11.02 million had been received to the Research Organization in 2015 from United Nations Development Program to implement Community Based Landslide Mitigation Programmes. Out of that a sum of Rs 6.00 million had been utilized in 2016 and the balance amount of Rs 5.02 million had remained unutilized even as at 31 December 2018.	It is expected to utilize the funds to implement Community Based Landslide Programmes in future.	Action should be taken to use the fund for intended purposes.

3.4 Delays in Implementation of Projects or Capital Works

The following observation is made.

Audit Observation	Comments of the Management	Recommendation
The landslide mitigation project implemented at Atale Maha Vidyalaya in Kalutara district scheduled to be completed within 150 days had shown slow progress of 30 per cent even after lapse of 82 days up to 31 December 2018 from the date of commencement.	The works under the land slide mitigation project at Atale Maha Vidyalaya had been completed 90 per cent at present. The balance part is expected to be completed and hand over to the respective parties within next 02 months.	Action should be taken to complete the project at the agreed date in order to minimise the additional costs and extra costs thereon.

3.5 Procurement Management

The following observations are made on the procurement activities implemented on the construction of new office and laboratory building of the Research Organization.

Audit Observation	Comments of the Management	Recommendation
<p>(a) The period of the contract for construction of the new office and laboratory building of the Research Organization had been extended 03 times and scheduled to be completed by 21 December 2017. However, the construction works had not been completed even as at 31 December 2018</p>	<p>The matters involved for the delays of the construction works were remained out of the control of the contractor.</p>	<p>(a) Action should be taken to influence the contractor to complete the works during the agreed period.</p> <p>(b) The action should be taken by the Research Organization to minimise the matters out of the control of the contractor as enable to implement the contract management activities in efficient manner.</p>
<p>(b) According to the paragraph 4.5 of the contract agreement, it was determined that the minimum value of an Interim Payment Certificate amounted to Rs 12.50 million. However a sum of Rs 95.74 million had been paid during the year under review through the Interim Payment Certificates with below the minimum value determined. Further, a sum of Rs 38.31 million had been paid to the external agencies on behalf of the contractor.</p>	<p>The human and physical resources are adequately deployed at the work site in order to increase the progress of the construction works . For that purpose, the liquidity problems of the contractor is needed to be remained satisfactory. Therefore, the action had been taken to settle the payment eventhough it was remained below the minimum value of the Interim Payment Certificate. Further, the contractor had faced with the financial difficulties and as a result, the major items such as Concrete bars, bricks could not be made available. Therefore, according to the agreement entered at the discussions with the related parties, the payment had been made directly to the sub contractor and deduct the amount claimed from the bills of the contractor.</p>	<p>Action should not be taken to allow rooms to receive additional financial benefits to the contractor. The direct payments made to the sub contractors are treated as the release of advances without obtaining guarantee bonds. Therefore it is essential to avoid such instances due to high financial risk involved therein.</p>

- (c) A sum of Rs 3.73 million had been spent for the year 2018 to hire a building to locate offices of several divisions of the Research Organization due to delays in completion of the construction works of the new office building and the laboratory. Further a sum of Rs 8.88 million had been spent to obtain consultancy services from the officers of the Research Organization itself.
- The rent expenses had been incurred due to delays in completion of the construction works at present, the main structural works had remained in the final stage and action had been taken to complete the construction works promptly.
- (a) Action should be taken to control additional expenses.
- (b) It is proved that the expected cost advantage through providing of consultancy services from the Research Organization itself is remained doubtful.
- (d) Contract for the electric and pumping works of the building had been awarded to a separate contractor and according the contract agreement the respective works scheduled to be completed on 29 May 2018. However, such works had not been completed as at that date, as the delays in completion of the building construction works. Further, a single Interim Payment Certificate to claim a sum of Rs 1.89 million had only been submitted and outstanding balance of Rs 2.16 million had remained in the hand of the contractor over a year as at 31 December 2018.
- The electric and pumping works of the building had remained with delays due to lateness of the construction works of the building. The rates presented by the contractor involved in pumping works are not allowed to change and only the price variations are considered. Further, the settlement of advances are done according to the provisions of the contract agreement. Therefore, the advance is recovered partly according to the bills submitted on works completed.
- Action should be taken to influence the contractors to complete the works on due dates stipulated in the agreement for the purpose of controlling costs in efficient manner.
- (e) Allocations amounting to Rs 450 had been released by the General Treasury at the end of the year under review to construction of new office building and out of that a sum of Rs 206.25 million had been utilized as at 31 December 2018. Therefore, the unutilized allocation of Rs 243.75 million had remained in the Bank Accounts of the Research Organization without being utilized for the intended purposes.
- The estimated cost of the construction of this building amounted to Rs 600 million and allocation amounting to Rs 450 million had been released from the General Treasury. The balance amount is expected to be borne by the Research Organization. Further, the contracts had been awarded at a cost of Rs 587 million at present. The balance of the allocation is expected to be used to settle bills presented by the contractors based on the physical works completed.
- The contract management activities should be done in prudent manner to utilize the allocated funds efficiently.

3.6 Deficiencies in Contract Administration

The following observation is made.

Audit Observation	Comments of the Management	Recommendation
The contract on installation of 50 units of automated rain gages awarded in 2017 had not been completed by the respective contractor during the agreed period. However, without consider that fact, another contract to install 30 units of rain gages had been awarded to the same contractor in 2018.	The respective contractor had properly completed the works on installation of rain gages under the contract awarded in 2017 , at the time of evaluation of bids called in 2018.	The intended objectives are needed to achieve by taking necessary steps to complete the activities on time.