

## **Head-103 – Ministry of Defence**

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### **1. Financial Statements**

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#### **1.1 Qualified Opinion**

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The audit of the financial statements of the Ministry of Defence for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 and the statement of financial performance and cash flow statement for the year then ended 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. The summary report containing my comments and observations on the financial statements of the Ministry of Defence was issued to the Chief Accounting Officer on 29 June 2021 in terms of Section 11 (1) of the National Audit Act No. 19 of 2018. The Annual Detailed Management Audit Report was issued to the Chief Accounting Officer on 21 October 2021 in terms of Section 11(2) of the National Audit Act, No. 19 of 2018. This report is submitted to Parliament in pursuance of provisions in the article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka to be read in conjunction with Section 10 of the National Audit Act No. 19 of 2018.

In my opinion, except for the effects of the matters described in paragraph 1.6 of this report, the financial statements give a true and fair view of the financial position of the Ministry of Defence as at 31 December 2020, and its financial performance and cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

#### **1.2 Basis for Qualified Opinion**

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My opinion is qualified based on the matters described in paragraph 1.6 of this report. I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibility for the financial statements is further described in the Auditor's Responsibilities Section. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

#### **1.3 Responsibilities of the Chief Accounting Officer and the Accounting Officer for the Financial Statements**

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The Chief Accounting Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with Generally Accepted Accounting Principles and provisions in Section 38 of the National Audit Act, No.19 of 2018 and for the determination of the internal control that is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

In terms of Sub-section 38(1)(c) of the National Audit Act, the Chief Accounting Officer shall ensure that an effective internal control system for the financial control exists in the Ministry at and carry out periodic reviews to monitor the effectiveness of such systems and accordingly make any alterations as required for such systems to be effectively carried out.

#### **1.4 Auditor's Responsibilities for the Audit of the Financial Statements**

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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 summary 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 and its materiality depends on the influence on economic decisions taken by users 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:

- Appropriate audit procedures were designed and performed to identify and assess the risk of material misstatement in financial statements whether due to fraud or errors in providing a basis for the expressed audit 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.
- An understanding of internal control relevant to the audit was obtained in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Ministry's internal control.
- Evaluate the 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.
- Evaluate the overall presentation, structure and content of the financial statements including disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Chief Accounting Officer regarding, among other matters significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

## 1.5. Report on Other Legal Requirements

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I express the following matters in terms of Section 6 (1) (d) of the National Audit Act, No. 19 of 2018.

- (a) The financial statements are consistent with the preceding year,
- (b) The recommendations made by me on the financial statements of the preceding year had been implemented.

## 1.6 Comments on Financial Statements

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### 1.6.1 Deposits

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The following deficiencies were observed in the payment of deposits and accounting for balances relating to the financial statements.

| Audit Observation<br>-----  | Comment of the Chief<br>Accounting Officer<br>-----   | Recommendation<br>-----  |
|---|---|--|
| (a) During the period under review, the difference between the balance shown in the Ministry Books and the balance shown in the Treasury Print Outs (SA 30) on Deposit Receipt and Deposit Payment Balances should be transferred to the Imprest Adjustment Account. However, according to the calculations made during the audit, a difference of Rs. 32,628,000 was observed between the amounts to be transferred and the amounts transferred to the Imprest Adjustment Account. | The value difference of total receipts and payments does not have an overall effect on the Imprest Adjustment Account as it takes the same value in both cases. | The adjustment account should be prepared on the correct values. |

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|-----|---|--|---|
| (b) | <p>According to the information furnished to the audit, The contract retention amounting to Rs.470,693,653 relevant to 79 contract works were remained as at 31 December 2020 and out of this, Rs. 231,094,300 remained unpaid for more than two years. Further, although the works of 12 contracts related to Rs.88,382,691 had been completed in it, a sum of Rs.48,362,756 had not been settled out of it even as at 31 March 2021. Further, no action had been taken to identify the deficiencies and recover related to those constructions or to release the retention money in accordance with Financial Regulation 571.</p> | <p>As the Security Forces Headquarters construction project is currently in progress, the retentions can be released once they are qualified and approved.</p> | <p>Action should be taken in accordance with Financial Regulations.</p> |
|-----|---|--|---|

## 1.6.2 Property Plant and Equipment

| Audit Observation   | Comment of the Chief Accounting Officer   | Recommendation   |
|---|---|--|
| <p>(a) Although the value of asset acquisition for the year under review as per Treasury Printouts and Statement of Financial Performance is Rs. 4,405,767,203 , the Statement on Non-financial Assets (Form ACA-6) stated that the amount as Rs.28,299,595. Accordingly, a difference of Rs. 4,377,467,608 was observed.</p> | <p>The reasons for these are the inclusion of certain purchases as opening balances in 2020 and capitalized in 2021, lack of facilities to enter purchases made for existing buildings online, assets purchased for the construction project had not been accounted through the CIGAS programme, the identified assets accounting as the opening balance of the year 2020 and it couldn't be accounted as assets of the Ministry as the assets belong to the three Armed Forces even though</p> | <p>The asset acquisition value as per the financial performance statement should be the same as its value shown in the schedule.</p> |

the provisions had been provided by the Ministry, etc.

- (b) According to the statement of non-financial assets included in the financial statements for the year 2019, the closing balance of non-financial assets as at 31 December 2019 was Rs. 9,143,240,909 and the opening balance as at 01 January 2020 was shown as Rs. 27,480,074,788 as per the financial statements for the year 2020. Accordingly, when the balance was brought forward, an increase of Rs. 18,336,833,879 was observed. This difference was due to the correction of errors in previous years and the adjustment of the transactions on assets transferred to other State Ministries during the year under review to the opening balance.
- The reasons for this difference were the correction of opening balances of assets belonging to the Ministry and removal of fixed assets belonging to the divisions leaving this Ministry from the Ministry of Defense during the year 2020.
- The opening balance should be correct and any adjustments made to the opening balance should be disclosed.

### 1.6.3 Exceeding Limits

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| Audit Observation   | Comment of the Chief Accounting Officer   | Recommendation                             |
|---|---|--|
| -----   | -----   | -----                                      |
| Although maximum expenditure limit imposed is Rs.38,500,000 on the Advance Account No. 10301 of the Public Officers, the actual cost is Rs.58,908,903 and it was observed that an expenditure of Rs.20,408,903 had been incurred exceeding the maximum expenditure limit. A request had been made to the Treasury for this amendment but it was not revealed that the approval for it had been received even as at 03 March 2021. | The Department of National Budget had informed orally that it has been included in the Order Book dated 12.05.2021 seeking approval for the amendment of the limits. Accordingly, it was further kindly inform that the Ministry of Finance should obtain information regarding the approval for the amendment. | It should be adhere to the advance limits. |

#### 1.6.4 Non-maintenance of Registers and Books

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| <b>Audit Observation</b>   | <b>Comment of the Chief Accounting Officer</b> | <b>Recommendation</b>   |
|--|--|---|
| (a) Inventory Book had not been maintained by the Research and Development Center in terms of Financial Regulation 454 (1) and the ledger of the State Intelligence Service Jaffna-Board No. 4 also had not been balanced. | Action will be taken to rectify in the future. | An inventory book should be updated and maintained in accordance with General Form 44 as per the provisions of Financial Regulation 454 (1).            |
| (b) A Security Register had not been maintained by including the details about the officers and employees who should deposit securities in accordance with Financial Regulation 891 (1).                                   | -do-   | A Security Register should be maintained by including the details about the officers who should deposit securities as per Financial Regulation 891 (1). |

#### 1.6.5 Certification of Chief Accounting Officer

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| <b>Audit Observation</b>  | <b>Comment of the Chief Accounting Officer</b>  | <b>Recommendation</b>  |
|---|---|--|
| Accordance with the provisions of Section 38 of the National Audit Act No. 19 of 2018, the Chief Accounting Officer should ensure that an effective internal control system is set up and maintained for the financial control of the Ministry and the efficiency of the system should be reviewed from time to time and necessary changes should be made to ensure that the system runs efficiently. Although those reviews should be done in writing and a copy should be submitted to the Auditor General, the statements of such reviews had not been submitted to the audit. | Relevant officials had been instructed to submit properly from the year 2021 onwards. | It should comply with the provisions of Section 38 of the National Audit Act No. 19 of 2018. |

## 2. Financial Review

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### 2.1 Revenue Management

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The following observations are made.

| <b>Audit Observation</b>  | <b>Comment of the Chief Accounting Officer</b>   | <b>Recommendation</b>  |
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| -----   | -----  | -----  |
| (a) The outstanding revenue was US \$ 24,082,696 to be recovered as at 31 December 2020 from United Nations Peace operational activities were done by Sri Lanka Air Force and Sri Lanka Army and out of this outstanding revenue, a sum of US \$ 13,024,132 was in the period from 01 to 04 years.  | The Permanent Mission to the United Nations had notified the relevant authorities to recover the late payments. Follow-up and monitoring actions are done by the Ministry of Defence.  | Action should be taken to recover the outstanding revenue and follow-up action should be taken on it continuously. |
| (b) Although the Sri Lanka Air Force had predicted revenue of Rs.1,740 million during 2020, the collected revenue for the year under review was only Rs.121.79 million. Accordingly, the progress in recovering the estimated revenue was as low as 7 per cent. Further, the revenue recovery efficiency could not be calculated because the Sri Lanka Army had not submitted a revenue estimate for the year under review. | The prevailed pandemic had led to delays in payments for peacekeeping operations. However, steps have been taken to raise awareness with the United Nations through the Ministry of Defence to recover the arrears. Revenue Estimates of the Sri Lanka Army from the year 2021 have been submitted to the Department of Fiscal Policy. | -do-   |
| (c) In accordance with Financial Regulations 85 (1), 85 (2) and Fiscal Policy Circular No. 01/2015 dated 20 July 2015, although it had been emphasized that revenue projections and estimates should be submitted to the Department of Fiscal Policy  | Steps had been taken to submit the revenue estimates for the Sri Lanka Army and the Sri Lanka Air Force to the Department of Fiscal Policy from the year 2021.   | Action should be taken in accordance with Financial Regulations and Circulars.                                     |

for revenue forecasting, the revenue estimate of the Sri Lanka Army was not included the revenue code 20.03.06.00 – United Nations Peacekeeping Operations in the estimate submitted by the Ministry for the year 2020.

- (d) In accordance with paragraph (05) of the Fiscal Policy Circular No. 01/2015 dated 20.07.2015 and the provisions of the Financial Regulations 128 (2) (i), although the fees charged for various services may need to be revised from time to time to taking into account changes in the economic situation when necessary, the gun license fees levied under the Firearms (Amendment) Act No. 22 of 1996 had not been amended in a timely manner.
- The drafts for amendments to the Firearms Act No. 22 of 1996 had been referred to the Legal Draftsman's Department.
- Action should be taken to revise the fees as per the circular.
- (e) According to the revenue arrears report, the arrears revenue of explosives, gun license fees and other fees as at 31 December 2020 were Rs. 421,890. Satisfactory steps had not been taken to recover these arrears in a timely manner.
- This is due to firearms owners going abroad, dying, leaving the business, not being aware of the transfer of firearms, the firearms keep as legal objects, curfews and travel restrictions.
- Action should be taken to recover the arrears and follow-up actions should be taken.



## 2.2 Expenditure Management

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The following observations are made.

| <b>Audit Observation</b>   | <b>Comment of the Chief Accounting Officer</b>   | <b>Recommendation</b>   |
|--|--|---|
| -----  | -----  | -----   |
| (a) The total value of Rs. 2,430,000 provided for 07 Recurrent Expenditure Objects was completely transferred to other Expenditure Objects.  | Although the expenditure for the Ministerial staff was estimated, the expenditure was not utilized as the Hon. President holds the post of Minister of Defence.  | Annual Estimates should be prepared as complete and accurate as possible in accordance with Financial Regulation 50 (ii). |
| (b) A sum of Rs. 26,025,465 or an amount more than four times of provisions of Rs. 6,476,000 provided for three Object Codes had been transferred to those Expenditure Cords under FR. 66 and 48 per cent of the net provision or Rs. 15,503,187 of provisions had remained after those transfers.   | This was due to the fact that the provisions allocated by the Supplementary Account were insufficient and additional provisions had to be transferred under FR 66 and the provisions made for the renovation of buildings were inadequate. | Transfer of provisions should be done with proper management.   |
| (c) The total allocation made for 09 Capital Expenditure Objects was Rs.27,575,000 saved in full. Further, the provision for Capital Expenditure on 07 Objects totalling Rs.17,067,690 and the total provision for 7 Recurrent Expenditure Objects of Rs.21,161,878 were saved. Those savings ranged from 25 per cent to 99 per cent of the allocated net provision. | This was due to the fact that the Ministerial staff was not established inside the Ministry and the expenses were not as expected due to the Covid pandemic.   | The estimate should be prepared by properly identifying the needs.  |

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|-----|--|--|------|
| (d) | The provisions of Rs.11,761,800 had been transferred under FR.66 by expressing the reasons such as inadequate provision for 03 Objects of Capital Expenditure which had been allocated Rs.10,504,800 and incurring essential expenditure and incur essential expenses. But the provision of Rs.13,719,362 had been saved including the entire provision so transferred . | The provisions had been saved due to the reasons such as the non-establishment of Ministerial staff inside the Ministry, disruption of procurement activities due to the Covid pandemic, travel restrictions and delays in building repairs etc. | -do- |
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### 2.3 Incurring of Liabilities and Commitments

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The following observations are made.

| <b>Audit Observation</b>  | <b>Comment of the Chief Accounting Officer</b>  | <b>Recommendation</b>  |
|---|---|--|
| -----   | -----   | -----  |
| (a) According to note No. (iii) and (iv) in the financial statements submitted, the total value of liabilities and commitments as at 31 December 2020 was Rs. 573,999,564 and the amount of liabilities and commitments shown in the Treasury Printouts was Rs. 629,436,279. Accordingly a difference of Rs. 55,436,715 was observed.   | This was noted for future attention.  | The accurate values should be shown by comparing with Treasury Computer Printouts. |
| (b) According to Financial Regulation 94, any liability or expenses for providing work or service should not be incurred unless the financial provisions of the Annual Estimates are provided. Also, in accordance with paragraph 2 (d) of Public Accounts Circular No. 255/2017 dated 22 April 2017, all liabilities related to a particular financial year must be paid and released within | This situation had been caused by the revision of the provisions made under the 04 Supplementary Accounts and the increase in recurrent expenditure due to the Covid 19 pandemic. | Action should be taken in accordance with Circulars and Financial Regulations.     |

that year and no liabilities should be carried forward with the intention of settling in the next financial year. However, it was observed that the Ministry was liable for liabilities amounting to Rs. 47,991,066 in respect of 17 expenditure items in excess of the annual provision.

- (c) At the sample test on payment vouchers in January 2021, the expenditure totalling Rs. 3,742,387 out of the 13 instances relating to the year 2020 had been spent from the provisions of the year 2021. But those expenses were not identified as liabilities in the financial statements for the year 2020. As a result, the liabilities of Rs.3,742,393 were understated.
- Records were kept to include all payments related to the previous year for the Statement of Liabilities in the future.
- Liabilities should be properly identified and stated in the financial statements.

#### 2.4 Non-compliance with Laws, Rules and Regulations

Instances of non-compliance with the provisions in laws, rules and regulations observed during the course of audit test checks are analyzed below.

| Reference to Laws, Rules and Regulations | <u>Observation</u><br>Non-compliance | Comments of the Chief Accounting Officer  | Recommendation                                   |  |
|--|--------------------------------------|---|--|--|
| (a)                                      | Financial Regulation 751 (1)         | Three vehicles of the National Cadet Corps at three camps in Mannar, Kurunegala and Puttalam had not been recorded in the inventory book. | Necessary actions will be taken on observations. | Action should be taken in accordance with Financial Regulations. |

- (b) Public Finance Circular No. PED/RED/2015/8/General (1) dated 09 October 2015 and Guideline No. 01 of the Public Finance Circular No. 01/2020 dated 28 August 2020. The loan balances due from transferees, deceased and retired, suspended, vacated posts and other officers as at 31 December 2020 was Rs.5,136,145 and the loan balance over 5 years included in that balance was Rs.2,751,519. The action had not been taken upon these outstanding loan balances in accordance with the Circular. These loan balances are loans that had been outstanding for more than 20 years and recovery procedures will continuously be implemented. Action should be taken in accordance with the Circulars.

### 3. Operating Review

#### 3.1 Planning

The following observations are made.

| Audit Observation   | Comment of the Chief Accounting Officer   | Recommendation  |
|---|---|---|
| -----   | -----   | -----   |
| (a) According to the annual estimates, although it is estimated to have an annual revenue of Rs. 1,820 million based on two revenue codes under the Ministry, according to the aforesaid Public Finance Circular an action plan was not prepared and included in the annual action plan indicating these revenue collection periods and corresponding performance levels. | Details of revenue collection as per the circulars are included in the Action Plan 2021.  | Action should be taken to act in accordance with the Public Finance Circular.   |
| (b) Although the Annual Action Plan prepared as per the previous circular should include an imprest requirement plan for the annual activities, it was not included.  | Although it was not included in the annual action plan, arrangements had been made to obtain imprest by preparing imprest plans from Supplementary Account and submitting them to the General Treasury. | According to the circular, the annual action plan should include an imprest requirement plan for the annual activities. |

- (c) The Annual Action Plan did not include the internal audit plan, the organizational structure of the institution updated for the relevant year, the approved and actual staff details etc. to be included in the Annual Action Plan as per the aforesaid Fiscal Circular.
- Organizational structure and staff details are included in the 2021 Action Plan.
- The Annual Action Plan should be prepared in accordance with the circular.

### 3.2 Delays in the Execution of Projects

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The following observations are made.

| Audit Observation   | Comment of the Chief Accounting Officer   | Recommendation  |
|---|---|---|
| -----   | -----   | -----   |
| <p>(a) Security Forces Headquarters Construction Project</p> <p>-----</p>   |   |   |
| <p>(i) The Security Forces Headquarters construction project was planned in two phases and a delay in the completion as planned targets was observed of construction work on Building No. 08, Communication Building and Security Building, which is scheduled to be completed during the year under review. Further, 96 major works were identified under the construction phase 01 of the main building complex, communication building, security building, drainage system and water pumping station and it was observed that 31 of these works did not make any physical progress in the year 2020.</p> | <p>Most of the construction work which was slow due to various reasons is now in its final stages. Also, despite the disruption caused by the Covid 19 pandemic, construction work will continue.</p> | <p>Achieving the desired goals as planned and contracts should be completed within the agreed time with proper execution of contract supervision and direction.</p> |
| <p>(ii) According to the Action Plan and Procurement Plan of the project, although it was planned to execute 25 contract works under 08 priority stages and 356 external contract works by utilizing Rs.10,008.62</p>   | <p>The contracts included in the Procurement Plan had achieved average progress of 57.92 per cent. Priority had been given to Buildings No. 08 and</p>  | <p>Contract work should be carried out as planned.</p>  |

million during the year under review, Only 146 tasks were executed during the year under review.

Army Headquarters on allocated provisions. A significant number of contracts under the 5 priority phases could not be executed and will be performed in 2021.

- (iii) According to the action plan for the year under review in relation to Keenhadeniya Phase 01, the construction valued at Rs.349.24 million was estimated and the budget allocation for the year under review was only Rs. 191.45 million. However, the financial and physical progress of that work had remained low as 37 per cent and 14 per cent respectively because Rs.70.97 million only had been utilized from that allocation as at 31 December 2020.
- This was due to the reduction in the number of construction workers due to the pandemic, weaknesses in the procurement of goods, delays in security bonds, delays in procurement and delays in imports.
- Financial and physical progress should be achieved as expected by utilizing the provisions.

(b) Strategic Security Communication Network Project

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The Strategic Security Communication Network project, which was launched to establish a common communication mechanism between the security services, was scheduled to be completed between 2014 and 2016 and the period was extended to 31 December 2020 with the approval of the Cabinet of Ministers dated 11 November 2019. According to the Action Plan 2020, although it was planned to construct communication towers, installation and commissioning of Microwave Radiation Systems, completion of Optical Fiber to Akuregoda and completion of Colombo City Security Communication Network by using Rs.882.75 million, the project period was further extended due to procurement delays related to this construction. Therefore, the objectives of the project

Cabinet approval had been granted to extend the duration of the project till 31.12.2022 for resumption of procurement activities due to the cancellation of the tender. Twenty two soundproof generators were located in 21 locations in the Strategic Security Communication Network and the construction of the rooms had also been completed by 31.12.2020.

Action should be taken to complete the project as planned.

could not be achieved in a timely manner. Further, the utilization of completed towers, equipment including 22 generators purchased in 2016 and 2017 for relevant objectives were being further delayed.

### 3.3 Management Weaknesses

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| <b>Audit Observation</b>  | <b>Comment of the Chief Accounting Officer</b>  | <b>Recommendation</b>   |
|---|---|---|
| -----   | -----   | -----   |
| There were 07 contract works for which the contract period was extended due to the inability to complete the contract within the expected time due to construction delays, delays in opening letters of credit etc. Relating to those, there were 24 time extension claims amounting to Rs.1,008,548,800 and the US \$ 4,445,076 submitted by 05 suppliers had remained at the end of the year under review and out of this, Rs. 8,640,502 was paid to two contractors. | The accuracy of the amounts submitted by the contractors had also been paid with the recommendation of the consulting firm and the approval of the Ministry of Defence.<br>The accuracy of the claims is checked and recommendations are made to the consulting firm. | Additional claims due to unnecessary delays, and uneconomic expenses should be minimized. |

### 4. Achievement of Sustainable Development Goals

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| <b>Audit Observation</b>   | <b>Comment of the Chief Accounting Officer</b>   | <b>Recommendation</b>   |
|--|--|---|
| -----  | -----  | -----   |
| Accordance to the Circular of the Secretary to the President No. PS/SP/SB/3/201 dated 16 March 2018, an accurate reporting of the achievement of the targets had not been done by setting up a database to measure the achievement of the Sustainable Development Goals. | The necessary steps will be taken in the future to measure the achievement of the Sustainable Development Goals through a specific database and report accurately. | Action should be taken with the objective of achieving the Sustainable Development Goals in accordance with the Circular. |

**5. Human Resources Management**

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The following observations are made.

| <b>Audit Observation</b>   | <b>Comment of the Chief Accounting Officer</b>                     | <b>Recommendation</b>                         |
|--|--|---|
| -----<br>The vacancies in 74 posts were observed out of the total approved cadre of 481 of the Ministry during the year under review. Out of it, 13 were senior-level posts. | -----<br>Action will be taken to fill the vacancies in the future. | -----<br>Adequate staff should be maintained. |