## Central Engineering Consultancy Bureau (CECB) - 2013

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The audit of financial statements of the Central Engineering Consultancy Bureau (CECB) and the consolidated financial statements of the CECB and its Subsidiary (Central Engineering Services Limited - CESL) for the year ended 31 December 2013 comprising the statements of financial position as at 31 December 2013 and the statements of comprehensive income, statements of changes in equity and cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 29 (2) of the State Industrial Corporation Act, No. 49 of 1957. My comments and observations which I consider should be published with the annual report of the Bureau in terms of Section 14(2)(c) of the Finance Act, appear in this report. The financial statements of the Subsidiary were audited by a firm of Chartered Accountants in public practice appointed by the Board of Directors of the respective Subsidiary.

### 1:2 Management's Responsibility for the Financial Statements

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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

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My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bureau's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bureau's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

## 1.4 Basis for Qualified Opinion

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

## 2. Financial Statements

### 2.1 Qualified Opinion

**(a) Qualified Opinion –Group**

In my opinion, except for the effects of the matters described in paragraphs 2.2 and 2.3 of this report, the consolidated financial statements give a true and fair view of the financial position of the Central Engineering Consultancy Bureau and its Subsidiary as at 31 December 2013 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**(b) Qualified Opinion–CECB**

In my opinion, except for the effects of the matters described in paragraph 2.3 of this report, the financial statements give a true and fair view of the financial position of the Central Engineering Consultancy Bureau as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### 2.2 Comments on Group's Financial Statements

The following observations are made.

(a) The following intercompany transactions disclosed in the individual financial statements as at 31 December 2013 had not been tallied each other and as a result the accuracy of those transactions and their impact to the individual and group financial statements could not be ensured in Audit.

| Item | Amount as per the Financial Statements of the Subsidiary | Amount as per the Financial Statements of the CECB | Difference |
|---|---|---|---|
| | Rs. | Rs. | Rs. |
| Construction Revenue/ (Expenditure) | 5,142,391,103 | (5,155,549,499) | 13,158,396 |
| Income / (Expenditure) for Hiring of Vehicles | 25,588,266 | (25,688,266) | 100,000 |
| Building Rent Income/ (Expenditure) | (132,000) | - | (132,000) |
| Fund Transfer to the CESL from | - | 6,368,258 | 6,368,258 |

the CECB

| | | | |
|---|---|---|---|
| Construction Expenditure Reimbursable / Payable | - | 320,545,239 | 320,545,239 |
| Consultancy Fee | - | 500,000 | 500,000 |

(b) According to the computation done by the audit, based on the information disclosed in the financial statements of the CESL in respect of related party transactions, the following overstatements in the Group financial statements were observed.

| Item in the Financial Statements | Balance as per computation done by Audit | Balance as per the Group Financial Statements | Amount Overstated |
|---|---|---|---|
| | Rs. | Rs. | Rs. |
| Mobilization Advance Payable | 3,657,367,563 | 4,209,970,258 | 552,602,695 |
| Mobilization Advance Receivable | 406,277,435 | 958,880,130 | 556,130,666 |
| Retention Money Receivable | 2,020,720,494 | 2,512,560,140 | 491,839,646 |
| Retention Money Payable | 196,175,386 | 697,074,921 | 500,899,535 |
| Debtors | 6,164,693,501 | 8,678,703,483 | 2,514,009,982 |
| Creditors | 2,519,573,670 | 3,768,792,440 | 1,249,208,770 |

## 2.3 Comments on Financial Statements of the CECB

### 2.3.1 Sri Lanka Accounting Standards (LKAS)

The following observations are made.

(a) **Sri Lanka Accounting Standards (LKAS 01) – Presentation of financial statements -** A sum of Rs.1,356,000 paid by the CESL to the key personnel of the CECB had not been disclosed under the related party transactions in the financial statements.

(b) **Sri Lanka Accounting Standards (LKAS 24) – Related Parties and Related Party Transactions,** The involvement of the management of the CECB in the operational activities of the Subsidiary i.e. The Deputy General Manager (Finance) of the CECB functioned as a Finance Manager of the Subsidiary and the Additional General Managers of the Base Offices of the CECB functioned as the Operational

Managers of the Base Offices of the Subsidiary had not been disclosed in the financial statements for the year under review.

### 2.3.2 Accounting Deficiencies

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The following observations are made.

(a) A sum of Rs.1,073,170,531 due from customer account balance shown in the financial statements as at 31 December 2013 had been understated by Rs.63,942,627 due to setting off a credit balance of the Project bearing No. D 1512 at Kandy Base Office.

(b) The Ministry of Economic Development had granted machineries and equipments valued at Rs.3,601 million to the Bureau in 2012 to expedite the road construction projects undertaken by the Bureau. However, the Ministry had recovered a sum of Rs.250 million from the contract payments due to the Bureau in this regard. Moreover, without carrying out any professional valuation of those assets and ignoring the grant portion of Rs.3,351 million, the Bureau had accounted them at Rs.250 million.

(c) Adjusted contract sum of two construction completed projects bearing Nos. 1481 and 1496 had not been taken into accounts in ascertaining the contract revenue of the year 2013 and as a result, the construction revenue shown in the financial statements had been overstated by Rs.658,567.

(d) The tax portion included in the mobilization advance balance relating to the consultancy fees had not been accounted separately and as a result, the Value Added Tax (VAT) and Nation Building Tax (NBT) payables and mobilization advance received shown in the financial statements as at 31 December 2013 had been understated and overstated by Rs.2,346,603, Rs.1,091,208 and Rs.3,437,811 respectively.

(e) Four invoices relating to the Projects bearing Nos. C 990, 991, 993 and 921 issued in 2013 had not been brought to the accounts and as a result, the debtor balance and contract revenue shown in the financial statements had been understated by Rs.9,384,637.

(f) According to the client certified bills, the retention money balance of the Project bearing No. 1597 was Rs.6,011,979. Nevertheless, according to the financial statements it was shown as Rs.1,602,337. Hence, the retention money balance and due from customer account balance shown in the financial statements as at 31 December 2013 had been understated and overstated by Rs.4,409,642 respectively.

(g) The goods valued at Rs.5,276,430 received in 2013 had not been brought to the financial statements of the year under review.

(h) The cash and cash equivalents amounting to Rs.18,972,443 shown in the financial statements had been included in the Deposit Advances of Rs.1,399,843 as well.

(i) According to the financial statements, the retention money receivable balances relating to nine Projects of the Badulla Base Office as at 31 December 2013 was totalling Rs.9,217,282. However, according to the certified bills, it was Rs.245,266,449. Hence, the retention money receivable balance shown in the financial statements as at 31 December 2013 had been understated by Rs.236,049,167.

(j) The Bureau had not considered the amounts in payment certificates / certified bills in ascertaining the year end debtor balances relating to six Projects and as a result, the debtor balances shown in the financial statements as at 31 December 2013 had been overstated by a net amount of Rs.20,766,409.

(k) An aggregate amount of Rs.321,793 in respect of two cheques issued in 2012 which were not presented to the Bank up to end of the year 2013 had remained in the accounts without being adjusted. As such the both cash balances and trade and other payables shown in financial statements had been understated by similar amount.

(l) The fees charged by the Consultancy Division to the Construction Division of the Bureau for the year 2013 amounting to Rs.85,374,137 had not been eliminated when preparing the consolidated financial statements and as such, both consultancy fees and the construction cost shown in the financial statements as at 31 December 2013 had been overstated by Rs.85,374,137.

(m) There was no any contract variation in respect of the Projects bearing Nos. 1397 and 1540 as at 31 December 2013. However, a contingency provision for Rs.10,980,249 had been made in the accounts in computation of the profit of those projects for the year 2013 based on the completion percentage method. As a result, the revenue shown in the financial statements had been overstated by Rs.4,888,575.

(n) Mobilization advance and retention money receivable balances shown under current assets in the financial statements in respect of Katubedda Base Office had been overstated and understated by of Rs.30,707,363 and Rs.240,482 respectively due to not taking the balance in the certified bills of the respective Projects.

(o) According to the approval granted by the Standard Technical Committee, the contract sum of the Project No. 1339 was Rs.22,786,975. Whereas, according to the financial statements it was Rs.23,524,219. Accordingly, the revenue had been overstated by Rs.737,244. Further, when comparing the revenue and the total cost of Rs.24,359,361, the loss sustained to the Bureau from that Project for year 2013 was Rs.1,572,786.

(p) Impairment assessment had not been done for the trade debtors and retention money receivable balances aggregating Rs.400,024,049 remained outstanding for more than five years as at 31 December 2013 at the Base Offices other than Sabaragamuwa and Battaramulla.

### 2.3.3 Unidentified Differences

The following items shown in the cash flow statements of the Group and the Bureau for the year under review had been differ from the figures used for profit calculations.

| Description | Amount as per Cash Flow Statement | Amount as per Income Statement | Difference |
|---|---|---|---|
| | Rs. | Rs. | Rs. |
| Bad and Doughtful Debts | 270,826,569 | 314,363,617 | 43,537,048 |
| Loss on Disposal of PPE | 1,319,392 | 18,907 | 1,300,485 |

### 2.3.4 Accounts Receivable and Payable

The following observations are made.

(a) Debtor balance of Rs.3,213,047 in relation to the Projects bearing Nos. D 542, 609, 210 and 566 had remained outstanding for more than five years as at 31 December 2013. It was further observed that, those balances had been remained as at March 2015 without being taken any recovery action.

(b) The outstanding debtor balance of Rs.415,769,642 remained unrecovered in the financial statements over a period of more than four years as at 31 December 2013 without being taken any recovery action.

(c) Even though 16 Projects implemented by Badulla and North Central Base Offices had been fully completed as at 31 December 2013, the dues from and dues to customer account balances of Rs.68,229,420 and Rs.12,306,686 respectively had been appeared under those projects in the financial statements of the year 2013 without being cleared.

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

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

| Reference to Laws, Rules, etc. | Non-compliance |
|---|---|
| (a) Section 14(1) of the Finance Act, No.38 of 1971 | A copy of the Draft Annual Report for the year under review had not been submitted along with the financial statements to the Auditor General. |
| (b) Public Enterprises Department Circular No. 95 of 04 June 1994 | Various allowances such as, retaining allowance, personal allowance, and professional allowance had been paid to the permanent and contract base |

employees of the Bureau without the approval of the General Treasury. Total amount so paid in 2013 was Rs 26,323,659.

## 3. Financial Review

### 3.1 Financial Results

According to the financial statements presented, the operations of the CECB and the Group for the year under review had resulted a pre-tax net profit of Rs.584,746,149 and Rs.610,013,445 respectively as compared with the corresponding pre-tax net profit of Rs.682,076,563 and Rs. 695,853,050 respectively for the preceding year, thus indicating a deterioration of Rs.97,330,414 and Rs.85,839,605 or 14.27 and 12.34 per cent respectively in the financial results. The increase of operating expenditure by Rs. 90,945,307 in the year 2013 as compared with the preceding year was the main reason attributed for this deterioration.

### 3.2 Analytical Financial Review

The following observations are made.

(a) The CECB had earned a pre – tax net profit of Rs.584 million during the year under review by utilizing its staff strength of 1,471 and total assets base of Rs.16,179 million Further, the profit is represented 3.6 per cent of the total assets of the Bureau.

(b) When analyzing segmental profit of the Bureau, the Construction Division and Consultancy Division represented 118.6 per cent and 55.5 per cent profit margin respectively while representing 74.1 per cent negative profit margin from other sources. The abnormal increase in Construction Divisions' profit emerged due to not applying the cost identification for calculation of profit as per LKAS 11 which mean not absorbing of indirect expenditure to relevant construction projects such as depreciation, staff cost, overtime, incentive for staff and Head office charges.

(c) Operating profit margin and net profit margin of the year under review was 2.56 per cent and 2.17 per cent respectively and as compared with the previous year, these profit margins had been decreased by 1.29 per cent and 0.86 per cent respectively.

### 3.3.1 Performance Review

The Consultancy Division of the CECB had been fully equipped with all necessary physical and human resources to serve the Nation in all types of engineering consultancies. However, at present CECB had mainly focused on construction works rather than consultancy in contrary to the objectives of establishing the Bureau.

The Chairman of the Bureau states in this regard as follows.

***The reason why CECB had to get involved in construction was since early 1990's was the lack of Consultancy work to sustain the staff it had inherited at the end of Mahaweli era.***

***The closest natural choice for CECB was to get involved in Construction work. What is important to remember is that CECB did not get involved in Construction work as any other contractor would do. It introduced and innovated the Engineer – Procure-Construction Methodology using the synergies of its Consultancy experience. However, with the improvement of the situation since conclusion of Terrorism, CECB too is gradually getting back to consultancy work while leaving Construction work to especially formed subsidiary name Central Engineering Services (Pvt) Limited.***

## 4. Operating Review

### 4.1 Transactions of Contentious Nature

The following observations are made.

(a) Board of Directors of the Bureau had approved number of incentive schemes and incentive payments to employees of the Bureau without getting prior approval of the General Treasury. Total amount of such incentives paid in 2013 was Rs.100,140,316.

(b) Out of 90 per cent of the construction contracts undertaken by the CECB had been sub-contracted to the CESL without allowing them to get contracts through competitive bidding, which is the main purpose in establishment of that Company.

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

### 4.2 Identified Losses

The following observations are made in this connection.

(a) A loss of Rs,60,369,218 had been incurred by the Bureau during the year under review in respect of 24 construction contract works undertaken due to poor performance in contract administration.

(b) The contract sum of the Project bearing Nos. 1353 approved by the Standard Technical Committee was Rs.27,112,744. But, the actual cost incurred for that project was Rs.37,523,409. Hence, the loss sustained to the Bureau on that project was Rs.10,410,665.

### 4.3 Human Resources Management

The approved and actual cadre of the Bureau as at 31 December 2013 was 1,132 and 1,471 respectively. As the recruitments had been done by exceeding the approved cadre in all employee categories by 339, a proper cadre management was not observed.

## 5. Budgetary Control

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Significant variances were observed between the budgeted and actual figures, thus indicating that the budget had not been made use of as an effective instrument of management control.

## 6. Systems and Controls

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Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the CECB from time to time. Special attention is needed in respect of the following areas of control.

(a) Assets Management
(b) Inventory Control and Stock Management
(c) Procurement of Construction Material
(d) Fund Management
(e) Invoicing of Contract Revenue
(f) Control over Debtors and Receivables
(g) Control over Creditors, Advances and Payables
(h) Performance Evaluation
(i) Contract Administration
(j) Investment and Control over Subsidiary
(k) Human Resources Management