# State Engineering Corporation Sri Lanka – 2016

The audit of activities and transactions of the Sri Lanka State Engineering Corporation ("the Corporation") for the year ended 31 December 2016 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. My observations on operations of the Corporation during the year under review, which I consider should be tabled to Parliament in terms of the Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka, appear in this report.

## 2. Financial Statements

### 2.1 Presentation of Financial Statements

Although Management is responsible for the preparation and fair presentation of the financial statements in accordance with Sri Lanka Accounting Standards, the annual financial statements pertaining to the year under review had not been furnished to audit even up to the date of this report in terms of Section 6.5.1 of the Public Enterprises Circular No. PED/12 dated 02 June 2003.

### 2.2 Comments on Activities of the Corporation

#### 2.2.1 Lack of Evidence for Audit

The following evidence indicated against each items of account shown below had not been submitted to audit.

| | Item | Value | Evidence not Made Available |
|---|---|---|---|
| | | Rs. | |
| (a) | Payable to Customers of the Service Division | 543,895,470 | Detailed schedules. |
| (b) | Taxes payable | 488,204,669 | Age analysis |

#### 2.2.2 Accounts Receivable and Payable

The following observations are made.

(a) Out of the balance of trade debtors amounting to Rs. 3,518,915,427 as at the end of the year under review, more than 95 per cent of the debtor balances are representing the amounts receivable from the Government Institutions and of them, a sum of Rs.969,867,663 or amount equal to 28 per cent had remained unrecovered for more than 05 years.

(b) Although an amount of Rs.7,450,055 had been continuously brought to the accounts as sundry debtors for more than 05 years, actions had not been taken to either recover or identify the related parties.

(c) Advances aggregating Rs.115,801,112 and Rs.159,646,390 given for various purposes and for different parties had not been recovered for more than three years and five years respectively.

**2.2.3 Un-explained Differences**

The following un-explained differences were observed.

(a) According to the information made available for audit the actual Value Added Tax payable was Rs. 11,043,549. However, it was shown in the schedules as Rs.4,792,320. Hence, an unexplained difference of Rs.6,251,229 was observed between those two figures.

(b) Differences totaling Rs.148,801,970 was existed between the debtor balances presented by the Corporation and the debtor confirmations received from 04 institutions. The reasons for these differences were not explained to audit.

**2.3 Non-compliance with Laws, Rules, Regulations, and Management Decisions**

The following instances of non-compliance were observed in audit.

| | Reference to Laws, Rules, and Regulations, etc. | Non-compliance |
|---|---|---|
| (a) | Financial Regulation 396 (d) of the Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka | Action had not been taken in respect of 5 lapsed cheques valued at Rs.289,188 which had not been presented for payment for over a period of 06 months as at 31 December 2016. |
| (b) | Section iii of Value Added Tax (VAT) Act, No. 14 of 2002 | Although input VAT Rs 8,321,188 and output VAT Rs.33,000,669 had been raised from transactions of the year under review, the returns on VAT had not been forwarded to the Department of Inland Revenue. |
| (c) | Nation Building Tax (NBT) Act, No. 09 of 2009 | Returns on NBT relating to the year under review had not been forwarded to the Department of Inland Revenue as requested. |
| (d) | Management Audit Circular, No. DMA/2009(2) dated 01 July 2009. | Information required to be included in the Fixed Assets Register had not been included as requested. |
| (e) | Treasury Circular, No. IAI/2002/02 of 28 November 2002. | A separate Fixed Assets Register for computer accessories and software had not been maintained. |

| | | |
|---|---|---|
| (f) | Employees' Provident Fund Act, No. 15 of 1958, and Employees' Trust Fund Act, No. 46 of 1980. | Surcharges of Rs.153.91 million and Rs.20.98 million had to be paid by the Corporation to the Employees' Provident Fund and the Employees' Trust Fund respectively due to un remittance of contributions of Rs.307.82 million and Rs.41.97 million to the respective Funds on the cost of living allowances paid to the employees since January 2006 to July 2015. |
| (g) | Section 2(c) of the Circular, No. 121/1979 of 20 December 1979 issued by then Chairman of the Corporation. | Once the advances are given in cheques together with orders, such advances should be settled within a period of 30 days. However, such advances totaling Rs.77,540,015 given had remained unsettled for more than 03 years. |

**3. Operating Review**

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**3.1 Performance**

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The main objectives of the Corporation are: (i) Investigation, planning, designing and construction of building, civil engineering and other engineering projects (ii) Provision of consultancy and project management services (iii) Undertake property development works (iv) Manufacture and sale of ready mix concrete, reinforced concrete and pre-stressed concrete products (v) Manufacture, sale, import and export of construction materials, machinery and equipment required for engineering projects/undertakings (vi) Training of engineering and technical personnel (vii) Carrying out of research into construction materials, methods and techniques utilized for the above purposes.

The following observations are made with regard to main activities performed during the year 2016 in order to achieve the above objectives.

(a) Out of 257 construction projects undertaken by the Construction Division of the Corporation by the end of the year under review, no expenditure had been incurred for 109 construction projects.

(b) It was observed that the progress of 13 construction projects was at zero level. The progresses of other main projects undertaken by the Corporations are given below.

Provincial Road Development Projects – Matale District

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The Corporation had been assigned 52 roads construction projects by the Ministry of Economic Development in the year 2011, and those contracts scheduled to be completed within a period of 06 months.

The following deficiencies were observed in this regard.

(i) An overpayment of Rs. 42,428,732 had been made to sub-contractors as the payments were not certified by the (Road Development Authority) Consultant.

(ii) A sum of Rs. 43.96 million had remained unrecovered with regard to 11 construction projects which completed over 90 per cent.

Provincial Road Development Projects – Ratnapura District

(i) The subcontracts had been awarded in the year 2011 for the construction of 02 roads with the contract values of Rs. 34.11 million and Rs. 26.8 million. However, the constructions works had not been completed even up to 31 March 2017. Actions had not been taken to recover the mobilization advances of Rs. 7.46 million and Rs. 06 million and liquidated damages of Rs. 3.4 million and Rs. 2.6 million from those subcontractors as per the conditions in the agreements. Further, the validity period of the performance and mobilization advance bonds furnished by said subcontractors had been elapsed.

(ii) It was observed that overpayments of Rs.1,550,945 had been made to the subcontractor of Theppanawa – Gorakaela road as a result of uncertified the bills by the Road Development Authority.

(iii) Although the construction works of the Kahangama part and the kossgala part should be completed by 31 December 2011, it had not been completed by the sub-contractors as agreed. However, the Corporation had not been recovered the liquidated damages of Rs.5,389,574 from the sub-contractors.

(c) Renovation of Building of the Department of Inland Revenue and Construction of Car Park

(i) Although Renovation should have been completed before 13 December 2009, it had not been completed even up to 31 December 2017.

(ii) The Department of Inland Revenue had informed to the Corporation that they will take action to recover a sum of Rs. 27,244,208 as liquidated damage from contract price in delaying the construction works.

(iii) The contract for the installation of elevators at the said vehicle park had been awarded to the Diesel & Motor Engineering Company and this company had filed a legal case against the Corporation by claiming Rs. 96.94 million as compensation on the ground of delaying the construction works.

(d) The Corporation had exempted from providing advance and performance bonds/securities in respect of negotiate contracts which are operated itself in terms of decision No. 08/C/73/344/002 taken by the Cabinet of Ministers. Although, according to this decision those exemption should not be applicable for works giving on sub contracts, such contracts to the value of Rs. 104.152 million had been given on subcontracts.

**3.2 Operation of the National Equipment and Machinery Institute (NEMO)**
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The following observations are made.

(a) A Value Added Tax amounting to Rs. 7,695,261 had not been imposed in respect of income earned through rented out the machineries in the year 2016.

(b) Value Added Tax and Nation Building Tax amounting to Rs. 123.84 million and Rs.7.8 million respectively that should have been settled to the Corporation had remained unsettled.

(c) A sum of Rs. 253.8 million payable to the National Housing and Development Authority had not been paid.

(d) Return on Nation Building Tax and recovery of Nation Building Tax of Rs.1,190,229 had not been remitted to the Department of Inland Revenue even up to 31 January 2018.

(e) The approved limit of bank overdraft facility had exceeded by Rs.6.8 million. Further, interest for overdraft amounting to Rs 15.8 million had been paid during the year under review.

(f) Unidentified credits and debits amounting to Rs. 1,328,763 and Rs. 111,605 respectively had been existed in the bank reconciliation statements since the year 2012 without being cleared.

(g) According to audit test check, it was revealed that agreements with relevant parties in respect of 05 construction projects had not been entered for. Further, no procurement procedure had been followed for selecting the contractors.

(h) Out of 17 workshops operating under this Institute, 09 workshops had been sustained a loss of Rs. 22.02 million in the year 2016.

(i) Although the approved cadre for the Institute was 344, the actual cadre as at 31 December 2016 was stood at 754. Nevertheless, the approval for 410 excess employees had not been obtained by the Institute.

(j) The cheque with order advance of Rs.465,516 had not been settled even as at the date of this report.

(k) Out of the machinery fleet, 91 machineries had been in un-serviceable condition.

### 3.3 Operations of other Divisions of the Corporation

The Corporation is functioning with five Divisions such as Construction Division, Construction Component Division, Mechanical and Electrical Division, Special Operations Division and Consultancy Division and the performance of the each Division is summarized as shown blow.

(a) Construction Division

No income had been generated by the Aluminum Factory in Rathmalana and Machinery Rental Site in Maligawatta pertaining to this Division during the year under review.

(b) Construction Component Division

As compared with the preceding year, deterioration in income and operating profit by 24 per cent and 9.16 per cent respectively were observed with regard to Precast Yard in Rathmalana. Further, the Carpentry Products Yard in Dankotuwa had been continuously running at loss since last 18 years even though it was reported an increase in sales income by 71 per cent during the year under review. In the meantime, the Precast Yard in Peliyagoda had not generated any income during the year under review as well as in the preceding year. However, an expenditure of Rs.115,296 incurred during the year under review.

(c) Mechanical and Electrical Division

(i) The Operating Yard Site No. 102 and Site No. 104 in Peliyagoda had continuously running at loss since the year 2013 and 2014 respectively and the loss of Rs. 1.6 million reported in the year 2013 by Site No. 102 had been increased to Rs. 45 million in the year under review. Meanwhile, a profit of Rs. 7.43 million reported by Site No.104 in the year 2013 had become a loss of Rs. 49 million in the year under review.

(ii) Dolomite Processing Plan in Matale (Site No. 1100) had continuously running at loss for last 17 years except the year 2006. However, the operating loss of Rs. 10 million in the year 2015 had decreased to Rs. 6 million or by 37 per cent in the year under review.

(iii) Ratmalana Yard (Site No. 888) had sustained an operating loss of Rs.21.81 million in the year under review due to increase of cost of sales and other expenditure.

(d) Special Operations Division

Although advances amounting to Rs. 29,642,269 were paid to the suppliers in the year under review for supply of raw materials to the Asphalt Plant at Galapatha, the materials valued at Rs.13,016,723 had not been supplied. Further, a rent of

Rs.1,800,000 was paid for 02 years period up to 25 December 2016 for this project. However, the production activities had been carried out only for 03 days. Hence, an accumulated loss of Rs.25,580,485 was sustained by this project.

**3.4 Identified Losses**

A surcharge of Rs.124,823,483 had been imposed by the Department of Inland Revenue due to non-payment of Value Added Tax, Economic Service Charge and Nation Building Tax on time. Further, the Value Added Tax and Economic Service Charge amounting to Rs.472,732,052 and Rs. 53,898,882 respectively had not been remitted to the Department of Inland Revenue even as at the end of the year under review.

**3.5 Transactions of Contentious Nature**

The following observations are made.

(a) A sum of Rs.94.44 million had been obtained from various organizations as key money during the period of 2013 to 2014 for allocation of trade stalls at the "C-City Project". However, the Project had not been completed even up to the end of the year under review. Hence, a client who paid Rs.735,000 as key money had filed a legal case against the Corporation by claiming Rs.1 million.

(b) A sum of Rs.341,368 had been paid as Value Added Tax in the years 2016 to 03 suppliers whose registration for Value Added Tax with the Department of Inland Revenue was cancelled.

(c) The credit balances totaling Rs.60,974,121 were existed in the advances paid account without being identified the respective vendors.

**3.6 Resources of the Corporation Released to Other Government Institutions**

Twelve employees to the Ministry of Housing and Construction, one officer to the Provincial Ministry and 04 employees to the Urban Settlement Development Authority had been released contrary to Section 8.3.9 of the Public Enterprises Circular No. PED/12 of 02 June 2003.

**3.7 Idle Assets**

Three vehicles and trailers to the cost of Rs.610,000 and a double cab vehicle which cost not made available and machineries costing Rs.3,500,000 had remained laying idle without being taken necessary actions thereof.

### 3.8 Staff Administration

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The following observations are made.

(i) 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 26 officers had been appointed on contract basis for 05 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, 624 excessive employees had been appointed for 41 posts in excess of the approved cadre as at 31 December 2016.

(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. 15 employees had been appointed to 11 unapproved posts. Making permanent of the appointments of the employees appointed to 07 posts there from had been questionable in audit.

## 4. Accountability and Good Governance

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### 4.1 Corporate Plan

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Although a Corporate Plan was prepared for the period of 2017-2021 in terms of Public Finance Circular No. 01/2014 dated 17 February 2014; the Plan had not been updated in the year under review. The following instances of failure in achieving objectives and goals included in the Corporate Plan were observed

(a) Even though it had been expected to improve the average minimum annual income of each Division of the Corporation by 5 per cent and to earn the annual additional income of 5 per cent from projects, the income had deteriorated in the year under review.

(b) Even though it had been expected to introduce a system for recovery of loans and to decrease the current credit level by 20 per cent, the amount of loans has not decreased to the expected level.

(c) Under the diversification of business activities, identification of new income earning fields and expansion of business activities had not been achieved.

### 4.2 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. Even though an Action Plan was prepared for the period from 2017 to 2021, the following key items were not included therein.

- Annual Budget (Including income, operating expenses, development expenses, statement of financial position, cash flow statement)
- Annual Procurement Plan including proposed major investments, capacity building and major procurements
- Human Resources Development Plan
- Loan Repayment Plan
- Internal Audit Plan

### 4.3 Budgetary Control

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

### 4.4 Tabling of Annual Reports

The Annual Reports for the years 2014 and 2015 had not been tabled in Parliament even by 20 July 2018 in terms of Section 6.5.3 of the Public Enterprises Circular, No. PED/12, dated 02 June 2003.

## 5. Systems and Controls

Weaknesses 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 | Observations |
|---|---|
| (a) Accounting | (i) Non accounting of taxes payable and the surcharges thereon. |
| | (ii) Failure to reconcile the Control Accounts. |
| (b) Financial Control | (i) Granting advances through cheques with the orders. |
| | (ii) Un recovery of long outstanding debtors. |
| | (iii) Significant delays in submitting the invoices to the clients |

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|---|---|---|---|
| | | (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) | Staff Administration | (i) | Releasing human resources to other institutions. |
| | | (ii) | Recruiting employees in excess over the approved cadre. |
| | | (iii) | Recruiting officers to the senior management posts on contract basis. |
| (d) | Assets Management | | Failure to take action to properly utilize the idle assets and to take over the ownership of lands. |
| (e) | Control of Stocks | | Failure to conduct annual verification at all sites |