State Engineering Corporation of Sri Lanka - 2017

The audit of activities and transactions of the State Engineering Corporation of Sri Lanka ("the Corporation") for the year ended 31 December 2017 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

Age analysis for taxes payable as at 31 December 2017 amounting to Rs. 886,178,453 had not been submitted to audit.

2.2.2 Accounts Receivable and Payable

The following observations are made.

(a) Out of balance of trade debtors amounting to Rs.2,839,674,961 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.1,228,553,068 or 43 per cent had remained unrecovered for more than 03 years.

(b) Although an amount of Rs.7,450,055 had continuously brought to 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.410,933,309 given for various purposes to different parties had not been settled even up to the end of the year under review. Out of that Rs.144,944,204 were remained unrecovered for over 5 years.

(d) According to the age analysis presented, the balance of creditors totaling Rs.226,121,330 and Rs.116,549,944 had remained unsettled for a period of 3 to 5 years and over 5 years respectively as at the end of the year under review.

(e) Credit balances totalling Rs.1,807,107 and debit balances totaling Rs.491,749 shown under creditors had not been individually identified.

2.2.3 Un-explained Differences

Differences totalling Rs.296,807,702 was observed between 05 debtor balances shown in the detailed schedule presented by the Corporation and the debtor confirmations received from respective debtors. 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 Regulations of the Government of the Democratic Socialist Republic of Sri Lanka	
(i)	Financial Regulation 396 (d)	Action had not been taken in respect of 13 lapsed cheques valued at Rs.380,936 which had not been presented for payment for over a period of 06 months as at 31 December 2017.
(ii)	Financial Regulation 233(1)	Action had not been taken to recover the labour sub-contract advances of Rs.169,539,789 from sub-contractors.
(iii)	Financial Regulation	According to the physical verification for the year under review the stocks shortage of 6130 items value of totalling Rs.5,632,278 were observed in site of Ekala. Further, excess stocks items 2957 value of totalling Rs.2,886,019 were observed those sites.
(b)	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.

(c)	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 by cheques together with orders, such advances should be settled within a period of 30 days. However, such advances of Rs.89,503,424 given had remained unsettled for more than 03 years.
(d)	Guideline 8.9.1(a) of the Procurement Guidelines 2006	A written agreement should be sign for supply of goods and services exceeding the value of Rs.500,000. However, in 13 instances such advances for over Rs.one million had been granted without signing in an agreement.

3. Operating Review

3.1 Performance

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 2017 in order to achieve the above objectives.

(a) Although mobilization advances totalling Rs.198,661,125 were received since the year 2010, no works whatsoever had been provided so far with regard to those mobilization advances.

(b) Mobilization advances given to sub-contractors for various construction works totalling Rs.2,945,423,776 had remained unrecovered for over 5 years and those projects had not been completed within the agreed period.

(c) A total loss of Rs.308,255,164 had been sustained by the Corporation during the year under review due to inefficiencies in execution of project works and a cumulative net loss of Rs.1,376,888,537 had been incurred from those projects at the end of the year 2017.

(d) The following strategies and activities expected to be implemented in the year under review had not been implemented.

Strategies:- (i) Maintain 20 percent energy saving in all building design.

(ii) Increase production of other pre cast products related to irrigation, water supply & other construction products by 5 percent of present level per annum.

Activities:- (i) Continuous checking of available ventures

(ii) Technical Auditing

3.1.1 Operations of the 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 and shown below.

(a) Construction Division

(i) No income had been generated by the Machinery Rental Site at Maligawatta functioning under this Division during the year under review.

(ii) Out of 23 ongoing projects operated by this Division during the year under review, 20 projects had reported a profit of totalling Rs. 44,310,106 while 3 projects had reported a total loss of Rs.319,716,399. Hence, a total net loss of Rs.275,406,293 was sustained from ongoing projects.

(b) Construction Component Division

As compared with the preceding year, deterioration in operating profit by 41 per cent was observed with regard to Precast Yard at Rathmalana. Further, the sales income of the Carpentry Products Yard at Dankotuwa had decreased by 26 per cent as compared with the preceding year while net loss increased by 22 per cent during the year under review. In the meantime, net profit of the Dematagoda Concrete Sleepers Yard and Welikanda Precast Yard had been deteriorated by 32 per cent and 90 per cent respectively as compared with previous year.

(c) Mechanical and Electrical Division

(i) The Operating Yard at Peliyagoda (Site No.104) had continuously running at loss since the year 2013 and a net loss of Rs.23 million was reported during the year under review.

(ii) The Dolomite Processing Plant at Matale (Site No. 1100) had continuously running at loss for last 18 years except the year 2006 and the net loss had been increased by 76 per cent as compared with previous year.

(d) Special Operations Division

Although advances amounting to Rs.29,642,269 was 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 as agreed and no income had been generated during the year by this Plant.

3.1.2 Operations of the National Equipment and Machinery Organization (NEMO)

The following observations are made.

(a) The details in respect of Value Added Tax (VAT), Nation Building Tax (NBT), Economic Service Charge (ESC) requested by the audit had not been presented. Hence, the actual payable balances of those taxes could not be satisfactorily ascertained in audit.

(b) VAT and NBT amounting to Rs.123.84 million and Rs. 7.8 million respectively had not been remitted to the Corporation as enable to forward same to the Department of Inland Revenue.

(c) A sum of Rs.235.8 million payable to the National Housing Development Authority had not been paid since the period from 2002 to 2011.

(e) The following weaknesses were observed with regard to the construction works of the National Youth Cope carried out in Southern Province.

(i) According to the audit test checks it was revealed that, the details of progress with regard to 05 construction contracts had not been made available in the sub-constructs files and the liquidated damages were not recovered from the sub-contractors even though these works had not been completed within the construct period. Further, selection procedures of the sub-contractors were not made available for audit.

(ii) The Corporation had released from providing advance bonds and performance /security bonds in respect of negotiate contracts which are operated them self by the Corporation in terms of decision taken by the Cabinet of Ministers on 06 February 2008. However, this relief should not be applicable in case of sub-contracting the works undertaken by the Corporation. Nevertheless, the Construction of Youth Cope had offered sub contracts without obtaining such bonds from subcontractors.

(iii) It was observed that out of 21 constructions works, 13 different type construction works had been awarded to the sub-contractor at rate of Rs.12,222,509 each while 08 such construction works had been awarded at rate of Rs. 3,121,253 each. The reasons for this had not been furnished to audit.

(iv) According to the audit test check it was revealed that 3 construction works received from National Youth Cope had been awarded to sub-contractors with an abnormal profit margin of 28 per cent to 34 per cent.

(e) Although the approved cadre for the NEMO was 344, the actual cadre as at 31 December 2017 was 785. Nevertheless, the approval for 441 excess employees had not been obtained by the Institute. Further, the NEMO had created 33 new posts without the approval of the Department of Management Services and 62 employees had been appointed to those 33 unapproved posts.

3.2 Matters of Contentious Nature

The following observations are made.

(a) Eighty eight (88) projects to the total value of Rs.5,570.74 million carried out by the Mechanical and Electrical, Construction Component and Construction Divisions of the Corporation had been completed before 2015. However, those projects shown less than 20 and 20 – 90 per cent of completion stages in profit calculation report of the year under review. In the meantime, 02 projects valued at Rs.149.17 million had not been taken into account when calculating the profit for the year under review.

(b) Although 03 projects had been terminated in the year 2014, an expenditure of Rs.12,651,414 and Rs.20,903,794 had been incurred in the year 2016 and 2017 respectively by the Road and Bridge Plant functioning under the Mechanical and Electrical Division.

(c) Although 34 projects had been completed before 2015 by the Mechanical and Electrical Division, Construction Component Division and Construction Division, an expenditure of Rs.11,479,060, Rs.1,480,131 and Rs.25,411,302 respectively had been incurred during the year under review. Out of those projects, 22 projects shown a profit of Rs.1,545,626 and 2 projects shown a loss of Rs.35,959,748

(d) Eight projects to the total value of Rs.232,766,966 which should be commenced in the year 2015 or before 2015 had not been commenced even up to the date of audit on 11 October 2018 by the Construction Division. However, some of those projects shown less than 20 per cent completion stages in profit calculation report.

3.3 Resources Released to Other Government Institutions

Twenty (20) employees of the Corporation had been released to the Ministry of Housing and Construction, Provincial Ministries and Urban Settlement Development Authority contrary to the instructions given in Section 8.3.9 of the Public Enterprises Circular No. PED/12 of 02 June 2003. Further, according to the provisions in the above Circular, salaries of these employees should be reimbursed from relevant institutions. However, salaries of Rs.7,271,960 and Rs.3,380,420 paid by the Corporation for the year 2016 and 2017 had not been reimbursed in respect of 11 employees even up to 30 September 2018.

3.4 Idle Assets

The following observations are made.

(a) The land used for the C-city project was remained idle as a result of discontinuation of this project.

(b) Stocks of aluminum bar and ceiling sheet owns to the Corporation remained in the main stores of NEMO without being utilized and taken into closing stock.

3.5 Identified Losses

A surcharge of Rs.114,399,641 had been imposed by the Department of Inland Revenue due to non-remittance of Value Added Tax, Economic Services Charge and Nation Building Tax on time. Further, Value Added Tax, Economic Services Charge and Nation Building Tax amounting to Rs.628,504,287, Rs.67,996,943 and Rs.15,130,647 respectively had not been remitted to the Department of Inland Revenue even as at the end of the year under review.

3.6 Staff Administration

The following observations are made.

(a) 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. However, 29 officers had been appointed on contract basis for 06 posts in the senior management level under higher salary scales. Further, 49 Superintended (Civil) had been also recruited on contract basis.

(b) 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, 850 excessive employees had been appointed for 39 posts in excess of the approved cadre as at 31 December 2017.

(d) In terms of Management Services Circular, No. 28 (ii), dated 01 August 2006 and the letter No. DMS/E3/43/4/265/1 dated 25 November 2009 of the Director General of the Department of Management Services, it had been informed that vacancies should not be filled, nor should new posts be created without approval of the Department of Management Services. However, 13 employees had been appointed to 10 un-approved posts.

4. Accountability and Good Governance

4.1 Corporate Plan

Although a Corporate Plan had been prepared for the period 2017-2021 in terms of the Public Enterprises Circular, No. PED/12 dated 02 June 2003, that Plan had not been updated in the year under review. Instances of failure in achieving objectives and goals indicated in the Corporate Plan were also observed. The following targets set out in the Corporate Plan had not been achieved as expected.

(a) 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.

(b) To introduce a system for the recovery of loans and to decrease the current credit level by 20 per cent.

(c) To identify new income earning fields and expansion of business activities under the Diversification of Business Activities.

4.2 Action Plan

Even though an Action Plan had been prepared for the year under review, the time periods had not been determined for achievement some objectives, strategies and activities mention in the Action Plan. It was further observed that, the following key items were also not included therein.

(i) Annual Budget by including income, operating expenses, development expenses, statement of financial position and statement of cash flows.
(ii) Annual Procurement Plan including proposed major investments, capacity building and major procurements
(iii) Human Resources Development Plan
(iv) Loan Repayment Plan
(v) Internal Audit Plan

4.3 Budgetary Control

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

4.4 Tabling of Annual Reports

The Annual Reports for the years 2015 and 2016 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 of 02 June 2003.

5. Systems and Controls

Deficiencies observed in systems and controls 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 systems and controls.

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