

General Sir John Kotalawala Defense University – 2017

The audit of financial statements of the General Sir John Kotalawala Defense University for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the comprehensive income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes 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 10(a)(2) of the General Sir John Kotalawala Defense University Act No. 68 of 1981. My comments and observations which I consider should be published with the Annual Report of the University in terms of Section 14(2)(C) of the Finance Act appear in this report

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector 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

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 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 judgements, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University'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 University'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 financial statements. Subsections (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 the extent of the audit.

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

1.4 **Basis for Qualified Opinion**

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. **Financial Statements**

2.1 **Qualified Opinion**

In my opinion, except for the effects of the matters described in paragraph 2:2 of this report, the financial statements give a true and fair view of the financial position of the General Sir John Kotalawala Defense University as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

2.2 **Comments on Financial Statements**

2.2.1 **Accounting Deficiencies**

The following observations are made.

- (a) The construction cost amounting to Rs.10,948,998 for the building belonging to the Coconut Processing Project of the Defense University where the construction had been completed by 31 December 2016 ,had been shown in the financial statements under work –in –progress even at the end of the year under review. Further, depreciation of an asset begins when it is available for use in terms of Paragraph 69 of the Sri Lanka Public Sector Accounting Standard 07. However, the said building had been used as physical fitness center by the Southern Campus of the Defense University from the year 2016 and provision for depreciation had not been made in that connection.
- (b) A sum of USD 177.33 million by foreign funds and a sum of Rs.3,165.82 million by domestic funds had been obtained by the University in the year 2013 as loans from the National Savings Bank. According to the particulars issued by the bank, a sum of Rs. 2,735.29 million equal to USD 17.63 million as foreign loan interest and a sum of Rs. 433.55 million as domestic loan interest should have been paid by 31 December 2017. However, domestic loan amount payable by 31 December 2017 had been over stated by Rs. 604, 324,000 due to the accounting made by interpreting loans obtained from the domestic funds as obtained from the foreign funds and converting based on the exchange rate as 1 USD equal to Rs. 155.15. Further, though the payment of loan interests should have been commenced from the year 2022, the said loan had been shown under the current liabilities in the financial statements.
- (c) A sum of Rs.6,757,093 equal to totalling of USD 43,552 which should have been recovered as at 31 December of the year under review for the supply of food and accommodation by the university for the foreign students had not been brought to accounts .

- (d) Air conditioners and fire distinguishers valued at Rs. 29,891,597 and electricity installation expenses valued at Rs. 136,586,867 had been included in the value of assets amounting to Rs. 1,873,445,037 shown under the development of lands under property, plant, equipment in the financial statements

2.2.2 Lack of Evidence for Audit

Buildings and other assets valued at Rs.13,874,542 brought forward in the financial statements continuously under work-in –progress from the year 2011 could not be verified physically in audit . Even though Land Development cost valued at Rs.43,803,874 was brought forward continuously in the financial statement under incomplete work from the year 2008 , the details on the assets represented the said value was not presented to audit.

2.3 Accounts Payable

Sums amounting to Rs.19,720,235, Rs.1,196,249,776 and Rs.2,186,922,093 had been shown in financial statements as at 31 December 2017 under creditors , accrued expenses and other creditors respectively and out of that ,the balances unsettled over a period of 02 years totaled Rs.85,014,562.

2.4 Non-compliances with Laws, Rules, Regulations, and Management Decisions

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
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<p>(a) General Sir John Kotalawala Defense University Act No. 68 of 1981</p>	<p>The Vice Chancellor and the Secretary to the Board of Management of the University had been performed as the members of the Board of Management even in the year under review contrary to the Act.</p>
<p>(b) Financial Regulations of the Democratic Socialist Republic of Sri Lanka (i) Financial Regulations 237(b)</p>	<p>Even though it should be certified that all the relevant goods received before payment made for the supplies and included in the relevant Stock Registers, contrary to that, a sum of Rs.83,283,251 had been paid as advances before purchasing goods in 619 instances during the year 2017. The balance of the advances amounting Rs.19,175,853 paid during the previous 5 years had not been settled even as at 31 December 2017 as above.</p>

(c) Procurement Guideline of the Democratic Socialist Republic of Sri Lanka 2006

(i) Guideline 8.9.1(b)

A formal letter of acceptance shall be issued for any Goods or Service contract exceeding Rs.500,000. However, formal letter of acceptance had not been entered in respect of 03 contracts of purchasing goods amounted to Rs.8,632,941 in the year under review.

(d) Public Finance Circular No.03/2015 dated 14 July 2015

(i) Even though sub-impressts granted for a particular purpose should be settled immediately after the completion of the purpose for which it is granted, the advances amounting to Rs.2,316,213 granted for 16 Officers had not been settled even at the end of the year under review.

(ii) In the granting of sub –impressts for a particular purpose , sub impressts should be granted up to a maximum of Rs.100,000 only for a staff officer at a time. When exceeding the said financial limit, the authority of the Treasury should be obtained. Contrary to that, the advances amounting to Rs.1,883,685 had been granted for 19 non staff grade officers.

3. **Financial Review**

3.1 **Financial Results**

According to the financial statements presented , the financial result for the year ended 31 December 2017 amounted to a deficit of Rs.48,769,301 as compared with the corresponding deficit of Rs.23,216,355 in the financial results for the preceding year, thus indicating a deterioration of Rs.25,552,946 of the financial results as compared with the preceding year. Even though the total income had been increased by Rs.393,632,900 in the year under review as compared with the preceding year, increase in the exchange loss by Rs.199,755,658 and the other expenses by Rs.219,430,188 to the payment of the contractors for the construction of the teaching hospital of the university by foreign currency, had mainly attributed to the above deterioration of the financial result.

In the analysis of financial results of the year under review and 04 preceding years, a continuous deficit in the financial result from the year 2013 up to the year 2017 had existed. However, after re-adjustment of the employees remunerations and the depreciation on non-current assets, the contribution of the University in the year 2013 amounted to Rs.359,865,269 had been increased up to Rs.446,202,208 in the year 2014 but it had been gradually decreased by the year 2015 and 2016. However, it had been increased by Rs.41,704,976 in the year under review as compared with the preceding year .

3.2 **Analytical Financial Review**

The following observations are made.

- (i) Benefit ratio on equity capital in the preceding year had been a minus value of 0.316 per cent and it had been decreased up to a minus value of 0.47 per cent in the year under review.
- (ii) It was observed a decline in the current ratio in the year under review as compared with the preceding year hence the relevant current ratios in the year under review and the previous year were 0.3 and 2.5 respectively. Reason for the decline of this ratio had been the loan obtained for the construction of teaching hospital was shown under the current assets in the year under review.

4. **Operating Review**

4.1 **Performance**

4.1.1 **Function and Review**

The following observations are made.

- (a) Even though this institute, been established under the John Kothalawala Defence Academy Act No.68 of 1981 for offering defense related degrees for the officers employed in security services had been upgraded to the university status by the amended Acts No.27 of 1988 and No. 50 of 2007 . However, Sections for vesting of power for the offering degrees for the students those who are not engaged in the security services had not been included in the said Act. However, degrees had been offered for 3,329 external students including 177 foreign students on the cash payment basis by 31 December 2017 from the beginning .
- (b) Approval of the Board of Management of the Defense University had been granted on 18 February 2011 for the allocation of 20 per cent of the admissions from the total students from the Ranaviru families for the other courses except the Medicine. However ,the basis for selection of that students had not been defined. As a result of that, actions had been taken to enroll students for the degree courses as lower Z score values for students from Ranaviru families and higher Z score values for the other students.

4.2 Management Activities

The following observations are made.

- (a) Contributions totalling Rs. 8,210,785 payable to the Employee Provident Fund & Employee Trust Fund for the period from 01 January 2006 to 11 May 2011 had not been remitted during the relevant period by the Deference University and it was observed at audit that there is possibility to impose surcharges . Even though , the payments relating to personnel emoluments should be paid by the Fund of the Defense University , the aforesaid contribution had been paid by the self-financial fund of the University on 14 June 2017 .
- (b) Even though 346 students are engaged with academic activities in the Southern Campus by 31 December 2017 ,it was observed that lecture halls capacity for academic purposes were not in sufficient level of this campus where having 8 lecture halls. Even though 166 students had been enrolled for the courses conducted in the Faculty of Computer Science of the Southern Campus at the end of the year under review , the academic activities had been conducted in a computer laboratory belonging to the Faculty of Built Environment and Space Science due to the insufficient facilities of computer study. As such , maintaining of library for the under graduates in a tin roof precast building of 1152 square feet was observed during the physical verification due to a permanent library building had not been constructed for the Southern Campus.
- (c) Approval had been granted as per the decision made by the Cabinet Meeting held on 10 January 2017 for the interim procedure for the administration of Teaching Hospital of the Defense University by a separate Board of Directors until the draft Act for the proposed Sir John Kotalawala Defense University is approved by the parliament. Accordingly, a Board of Directors consist of 13 members nominated by ex –officio and 6 members nominated by His Excellency the President had been appointed for the operating of the hospital activities. However, the administrative structure of the Teaching Hospital had not been defined up to 31 December 2017.
- (d) Even though the Southern Campus affiliated to the University had been established in a land 161. 7363 hectares in extent belonging to the Sewanagala Divisional Secretariat of Monaragala district and in a land 7.6838 hectares in extent belonging to the Board Of Investment s of Sri Lanka in Sooriyawewa Divisional Secretariat area in Hambantota district, action had not been taken to vest the legal ownership of those lands to the university.

4.3 Operating Activities

The following observations are made.

- (a) Construction of a Teaching Hospital in 4 stages at Werahera area had commenced on 4 April 2013 while constructions had been completed on 20 May 2017. Although purchasing of the medical apparatus had not been carried out as planned , it had been estimated USD

39,629,000 for the fixing of medical apparatus required for each stage. Thirteen units had been identified for the functioning of services to be operated in the hospital and the said sections had not been operated even at the end of the year under review due to the reasons such as unavailability of relevant staff, non-installation of medical apparatus etc.

- (b) Plans had been made to complete the constructions of the Southern Campus under 03 stages by commencing on year 2011 and it was proposed to complete the first stage on 2015 and to complete the rest stages at the end of the year 2019. However, it was observed that the activities at the stage two and the stage three were carried out slowly due to the insufficient funds.
- (c) A foreign loan amounting to Rs.23,102,546,177 equal to the USD 177.33 million on 29 April 2013 on a surety of the General Treasury and a domestic loan amounted to Rs.3,165,821,000 for the construction of the Teaching Hospital of the Defense University had been obtained from the National Savings Bank. Those loans should have been recovered at the end of the year 2033 by the University and the loan interests should have been paid by the income earned by the Defense University after the year 2018. However, it was observed that the recovery of the aforesaid loan was problematic as a result of a deficiency existed in the operating result of the University from the year 2013 to the year under review.

4.4 Transactions of Contentious Nature

Even though plans had been made to complete the construction work of the Teaching Hospital on 30 April 2015, obtaining of the loan amounting to USD 177.33 million which should have been obtained from the National Savings Bank had been delayed due to the construction work had delayed 02 years by 20 May 2017. The National Savings Bank had given written information as to add an additional loan value amounting to Rs.400 million for the settlement of the loss on the changing of foreign exchange ratios due to the delay of obtaining the aforesaid loan amount.

4.5 Cadre Administration

The following observations are made.

- (a) Details of the officers who attached to the Kotalawala Defense University from the Three Armed Forces were as follows .

Institution -----	No.of Staff Officers -----	No.of Non- staff Officers -----	Total -----
Kotalawala Defense University -Rathmalana	106	809	915
Teaching Hospital- Kotalawala Defense University	49	313	362
Southern Campus -Sooriyawewa	<u>11</u>	<u>85</u>	<u>96</u>
Total	166	1,207	1,373
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- (a) The officers of the Three Armed Forces had been released for the staff of the University as mentioned above and the emoluments and allowances of the said officers had been paid by the relevant Armed Forces. Even though instructions had been given by the Committee on Public Enterprises held on 23 March 2017 so as to obtain a proper approval in respect of the officers who attached to the University in addition to the approved cadre, action had not been taken to obtain such approval up to the end of the year under review.
- (b) Even though the approved cadre for 08 Faculties of the University was 369, the staff employed by 31 December 2017 consisted 284 officers. Although the number of approved Professors and Senior Lecturers for the said Faculties was 47 and 161 respectively, it was observed that the number attached by 31 December 2017 was only 19 and 99 respectively.
- (c) Even though the number of Lecturers approved in the two Faculties in the Southern Campus of the University was 75, the number employed as at 31 December 2017 was only 29 individuals. Although 12 posts of Professors had been approved for the said Campus, no any Professor had been recruited as at 31 December 2017. Even though, 40 posts of Senior Lecturers had been approved for the Southern Campus, only 13 Lecturers had been deployed as at 31 December 2017. Alternative opportunities for the deploying of an adequate academic staff had not been considered by the University.

5. Sustainable Development

5.1 Achievement of the Sustainable Development Goals

It was observed that the attention had not been paid on the Letter No.NP/SP/SDG/17 dated 14 August 2017 of the Ministry of National Policies and Economic Affairs and the Circular No.BD/CBP/4/1/2- 2018 dated 31 July 2017 of the Department of National Budget relating to the Agenda 2030 in respect of the Sustainable Development Goals of the United Nations. Accordingly, action had not been taken by the Defense University to identify the Sustainable Development Goals to be achieved according to the scope of the Defense University and the landmarks and the indicators for measuring on the targets. It was observed that failure to pay the attention on the financial provisions, human resources and physical resources due to the sustainable goals and targets had not been identified.

6. Accountability and Good Governance

6.1 Presentation of Financial Statements

According to Section 6.5.1 of the Public Enterprises Circular No. PED/12 dated 02 June 2003, although the financial statements should be furnished to the Auditor General within 60 days from the close of the financial year, the financial statements for the year 2017 had been furnished to audit on 17 May 2018

6.2 Internal Audit

The number of audit staff attached to the Internal Audit Division consisted with 04 officers and it had been converted to an institution which perform a broad role including the Southern Campus affiliated to the Defense University and the Teaching Hospital. However, it was observed that the attention had not been paid in respect of increase the staff of the Internal Audit Division as suitable for that purpose.

6.3 Procurement

Even though the University is prepared a Procurement Plan for each financial year , only the capital expenses expected to be financed by the Treasury provisions had been included in it. The said Procurement Plan had been approved by the Secretary to the Ministry of Defense and a Procurement Plan for the capital expenditure made by the self- financial fund by the Defense University and the relevant approval for that purpose had not been obtained.

6.4 Budgetary Control

Variances ranged from 21 per cent up to 73 per cent between the estimated expenditure and the actual expenditure in 05 expenditure units were observed during the year under review.

6.5 Unresolved Audit Paragraphs

Even though the Teaching Hospital of the University had been constructed in a land 47 acres and 37.9 roods in extent belonging to the Sri Lanka Transport Board ,the ownership of the said building had not been taken over even by 31 December 2017.

7. Systems and Controls

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

Areas of Systems and Controls	Observation
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(a) Contract Administration	Contracts awarded without entering into written agreements.
(b) Control of Purchasing	(i) Purchasing goods contrary to the Government Financial Regulations and Procurement Guidelines (ii) Payment of advances made before receiving goods .