

Conflict Affected Region Emergency Project (CARE) (Component A) – 2013

The audit of financial statements of the Conflict Affected Region Emergency Project (CARE) (Component A) for the year ended 31 December 2013 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 Schedule 2, Section II B of the Loan Agreement No.2626-SRI dated 07 June 2010 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

1.2 Implementation, objectives, Funding and duration of the Project

According to the Loan Agreement, then Ministry of Economic Development and presently, the Ministry of Policy Planning, Economic Affairs, Child, Youth and Cultural Affairs is the Executing Agency and the Provincial Road Development Department and Provincial Irrigation Department of the Northern Provincial Council are the Implementing Agencies of the Project. The objective of the Project is to restore and improve, livelihood, economic infrastructure and administrative and legal services in the conflict affected areas. As per the Loan Agreement, the estimated total cost of Component “A” of the Project is US\$ 74.49 million and out of that US\$ 67.26 million or 89 per cent of the total cost was agreed to be financed by the Asian Development Bank and the rest of US\$ 7.23 million or 11 per cent to be financed by the Government of Sri Lanka. The Project commenced its activities on 07 June 2010 and scheduled to be completed by 30 June 2013.

1.3 Activities of the Project

According to the Agreement, the activities relating to Component A of the Project is summarized below.

- Part 1 : Rehabilitation of approximately 100 kilometres of provincial roads in Kilinochchi District.
- Part 2 : Rehabilitation of approximately 100 kilometres of municipal and urban roads in the Northern Province and rural roads in the adjoining villages of the North Central Province.
- Part 3 : Rehabilitation of approximately 65 kilometres of national roads (B category) in the Northern Province.

1.4 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles. This responsibility includes; designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements,

whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

2. Scope of Audit and Basic of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide and audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal controls so as to ensure satisfactory control over Project management and the reliability of books, records, etc. relating to the operation of the Project.
- (b) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operation of the Project, the identification of the purchases made out of Loan etc.
- (c) Whether withdrawals under the Loan had been made in keeping with the specifications laid down in the Loan Agreement.
- (d) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles and presented fairly.
- (g) Whether the withdrawals from the replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.

- (h) Whether financial covenants laid down in the Loan Agreement had been complied with.

3. **Opinion**

So far as appears from my examination and to the best of information and according to the explanations given to me, and except for the effects of the adjustments arising from the matters referred to in paragraph 5 of this report, I am of opinion that,

- (a) The Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purpose for which they were provided.
- (c) the withdrawals from and replenishments to the Special (Dollar) Account during the year ended 31 December 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (d) the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Agreement, and
- (e) financial covenants laid down in the Loan Agreement had been complied with.

4. **Financial Statements**

4.1 **Financial Performance**

According to the financial statements and information made available, the expenditure of the Project for the year ended 31 December 2013 amounted to Rs.3,500,649,589. A summary of the expenditure for the Project as per financial statements for the year under review, expenditure for the preceding year and cumulative expenditure as at 31 December 2013 are summarized below.

<u>Item of Expenditure</u>	<u>Expenditure for the year ended 31</u>		<u>Cumulative Expenditure as at 31 December 2013</u>
	<u>December</u>		
	<u>2013</u>	<u>2012</u>	
	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>
Civil Works	3,298,020,502	2,291,866,077	6,272,047,574
Equipment	--	19,982,886	55,555,219
Consultancy	145,734,535	151,476,107	406,859,432
Incremental Operating Cost	30,401,900	37,655,435	105,235,694
Commitment charge	26,492,652	23,905,610	66,824,774
	<u>3,500,649,589</u>	<u>2,524,886,115</u>	<u>6,906,522,693</u>

4.2 Special Dollar Account

According to the accounts and information made available, the operations of the Special Dollar Account during the year under review and the balance as at 31 December 2013 are given below.

	<u>US\$</u>	<u>Rs.</u>
Opening balance as at 01 January 2013	2,861,840	363,913,910
Add: Replenishment	92,432	11,778,267
Revaluation gain	<u>-</u>	<u>2,387,110</u>
	2,954,272	378,079,287
Less: Withdrawals	<u>2,952,042</u>	<u>377,787,624</u>
Balance as at 31 December 2013	<u><u>2,230</u></u>	<u><u>291,663</u></u>

5. Audit Observations

5.1 Unexplained Difference

Receivable balances shown in the financial statements aggregating Rs 15,843,478 had not been agreed with the corresponding amount of Rs 6,665,458 shown in the Notes to the financial statement. The reason for the difference was not explained for audit.

5.2 Lack of Evidence for Audit

The quarterly and half yearly progress reports had not been prepared by the Consultant and rendered for audit.

6. Financial and Operating Review

6.1 Utilization of Funds

The following observations are made.

- (a) A comprehensive action plan covering projects components and the fund allocation with financial and physical targets fixing responsibility in monthly, quarterly and annually for covering entire period of the Project should be prepared to ensure the achievement of project objectives. However, such plan had not been prepared and implemented. Further, the progress of the Project, as a whole could not be properly evaluated in order to take corrective measures and to make necessary changes for achieving objectives set for.
- (b) According to the Project Proposal, allocations amounting to Rs. 8,648 million had been made for the Component A of the Project under 05 items of expenditure. The detailed analysis of the allocation and utilization of funds as at 31 December 2013 is shown below.
- (c)

<u>Item of Expenditure</u>	<u>As at 31 December 2013</u>		
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
	<u>allocated</u>	<u>utilized</u>	<u>unutilized</u>
	<u>Rs. million</u>	<u>Rs. million</u>	<u>Rs. million</u>
Civil works	7,934	6,272	1,662
Equipment	70	56	14
Consultancy	410	407	03
Incremental	161	105	56
Commitment charges	<u>73</u>	<u>67</u>	<u>06</u>
	<u>8,648</u>	<u>6,907</u>	<u>1,741</u>

6.2 Physical Performance

The activities of the Component A of the Project had been carried out under two sub components namely, rehabilitation of national roads and rehabilitation of provincial roads. All the contracts awarded under rehabilitation of the national roads and 31 contracts, out of 33 contracts awarded to rehabilitate provincial roads in the Northern Province had been substantially completed as at 31 December 2013. Agreements of other 02 contracts had been terminated due to poor performance of the contractors. The following observations are made on the contracts awarded by the Project to rehabilitate the provincial roads.

- (a) As a regular feature, the scope of the works under the contracts awarded by the Project had been changed. Out of 33 contracts implemented for the rehabilitation of provincial roads in the Northern Province, the initial cost of 06 contracts had been increased by Rs.123,572,237 whilst the cost of other 27 contracts had been decreased by Rs. 87,720,855 due to variations of the scope of the works. Thus indicated that the preliminary works such as carrying out of road surveys and preparation of Bill of Quantities etc had not been properly done.
- (b) Out of 11,850 metres of road work of Manthai - Parappukadanthan Road expected to be completed, only 11,550 metres of road works had been completed. However, the total payment of Rs. 5,911,274 had been released to the contractor without considering the works not attended.
- (c) According to the Clause 4.9 of the General Condition of Contract, the contractor should be adhered with quality assurance system as specified in the Manual for Constructions and Maintenance of Road and Bridges of the Institute of Construction Training and Development. However, several deficiencies in adherence of quality assurance such as laying of asphalt at Mount Camel Road under the rainy weather condition with low temperature and wet surface, testing not done for compaction of the Aggregate Base Course layer of Mahathmakant by- road and use of unsuitable material for edge widening purposes of Abubakkar Veethy Road had been observed during the field inspections made by the auditors.
- (d) According to the consultancy service agreements, consultant is liable to provide service to rectify the defects during the defect liability period. However action had not been taken to rectify the defects observed on rehabilitation of Uyilamkulam - Atkattiveli Road

, Thunukkai - Themmyakulam Road, Manthai - Parappukadamthan Road and causeways in Kokavil to Thunukkai Road.

- (e) The assets such as motor cycles, survey equipment, computers and lab equipment etc procured at a cost of Rs 15 million by the contractor, out of the funds provided by the Project had not been recorded as the assets owned to the Project. Further, 15 per cent of profit and overhead margin had also charged by the contractor.

6.3 Transaction in Contentious Nature

The following observations are made.

- (a) According to the consultancy agreement, the original documents handled by the Consultant should be handed over to the Project after completion of the contract. However, the correspondence files and documents related to the completed contracts of the Project had not been handed over by the Consultant eventhough the Project Director had made several requests.
- (b) According to the Clause 4.6.2 of General Condition of Contract , liquidated damages can be repaid only if the date of completion is extended. However, the liquidated damages amounting to Rs. 27,332,509 recovered on delays in completion of the rehabilitation of Manthai - Parappukadamthan Road had been repaid even though the period of completion had not been extended. Further, the liquidated damages of Rs. 1,287,056 deducted from final bill on rehabilitation of Murukandy - Akkaragankalam Road in Kilinochchi had also been refunded without being extended the period of the contract .
- (c) Office quarters belongs to the Provincial Road Development Authority in Vavuniya and Kilinochchi had been renovated by the Project at a cost of Rs 4.2 million eventhough such renovation works were not included in the scope of the road rehabilitation works.
- (d) It was revealed in audit that the Value Added Taxes amounting Rs 208,425,950 had been paid to 05 contractors whose registration numbers for Value Added Tax purposes were invalid.