

Local Government Enhancement Sector Project (Pura Neguma) - 2014

The audit of financial statements of the Local Government Enhancement Sector Project (Pura Neguma) for the year ended 31 December 2014 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 4.02 of Article IV of the Loan Agreement No 2790-SRI (SF) dated 21 October 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Local Government Enhancement Sector Project (Pura Neguma), then Ministry of Local Government and Provincial Councils, presently the Ministry of Provincial Councils and Local Government is the Executing Agency and the Provincial Councils in 07 Provinces are the Implementing Agencies of the Project. The main objective of the Project is to achieve improved local government infrastructure and effective delivery of services through accountable, financially and technically strengthened local authorities. As per the Loan Agreement, the estimated total cost of the Project was US\$ 68.8 million equivalent to Rs. 8,940 million and out of that US\$ 59 million equivalent to Rs.7,670 million was agreed to be financed by the Asian Development Bank. The Project commenced its activities on 01 July 2012 and scheduled to be completed by 30 June 2015. Subsequently, the period of the Project had been extended up to 31 December 2016.

1.3 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 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.

1.4 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. 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 Project`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 Project`s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) 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 operations of the Project, the identification of the purchases made out of the Loan etc.
- (d) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipments supplied under the Loan had been utilized for the purposes of the Project.
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (g) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles,
- (h) Whether the opening and closing balances, withdrawals from and 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 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,

- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and
- (j) Whether the financial covenants laid down in the Loan Agreement had been complied with.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purposes for which they were provided.
- (c) the opening and closing balances, the withdrawals from and replenishments to the Imprest Fund Account during the year ended 31 December 2014 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 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 Loan Agreement,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review		Funds utilized			
					during the year 2014		as at 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	59.00	7,670.00	10.19	1,325.00	8.14	1,057.55	10.97	1,425.64
GOSL	9.77	1,270.10	2.88	374.28	1.54	200.00	2.08	270.96
	68.77	8,940.10	13.07	1,699.28	9.68	1,257.55	13.05	1,696.60

Even though the activities of the Project are scheduled to be completed by 31 December 2016 only the proceeds of Loan of US\$ 10.97 million out of total allocation of US\$ 59 million representing 18.5 per cent had been utilized as at 31 December 2014. Therefore the possibility of use of entire allocation of the Loan during the rest of period of 2 years of the Project is remained questionable.

3.2 Physical Progress

According to the General Condition of the Project Preparatory Technical Assistance Report, the Project had agreed to allocate maximum a sum of Rs. 50 million each for 171 Pradeshiya Sabhas to construct their administrative and commercial buildings and improve community facilities etc.

The physical progress as at 30 June 2015 on sub project carried out is given below.

Province	Amount allocated	No of sub projects implemented	<u>As at 30 June 2015</u>		
			sub projects to be completed	sub projects completed	sub projects not commenced
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	Rs.				
	million				
North Central	650	24	12	12	-
Central	900	28	18	09	01
Sabaragamuwa	800	25	18	03	04
North Western	650	20	14	05	01
Uva	800	28	19	08	01
Southern	1,100	29	18	06	05
Western	500	17	15	02	-
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	5,400	171	114	45	12
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It was observed that physical progress of the 32 sub projects had remained slow ranging from 10 to 50 per cent as at 30 June 2015, whilst 12 works had not been commenced even as at that date.

3.3 Contract Administration

The following observations are made.

- (a) Although there was a risk of possible gem pits and underground tunnels in the Pelmadulla area neither adequate ground survey nor a certificate from National Building Research Organization had been obtained before determining the location for the construction of the multi-purpose building for Pelmadulla Pradesiya Sabha. At the time of the execution of the contract, it was found that there was a gem pit and underground tunnel at the site and construction works was abandoned. Due to this reason, mobilization advance and part payments made amounting to Rs.9.07 million and Rs.0.76 million respectively is considered to be as uneconomical.
- (b) Additional cost of Rs. 1.66 million had been spent for the construction of a new access road to the building constructed for Redeemaliyadda Pradeshiya Sabha, as a result of main entrance of the building was facing opposite side to the main road.

- (c) Several cracks ranging from 250 metres to 300.6 metres of the chainage from 0+320 kilometres to 0+375 kilometres and chainage from 1+330.6 kilometres to 1+390 kilometres of Daduhethemma - Kaparella Road was observed during the site inspections made by the auditors on 13 August 2015. This indicated the use of substandard concrete for the road works without making quality tests.

3.4 Fruitless Transaction

The following observations are made.

- (a) Re-Construction works of 12 shopping stalls, community hall and other works of Imaduwa Pradeshiya Sabha had been abandoned in June 2015 due to a risk on landslide and it was revealed that the site had been selected without proper ground surveys. As a result, a sum of Rs.3.9 million paid to the contractor was observed as a fruitless expenditure.
- (b) It was observed that the costs aggregating to Rs. 2.26 million spent for the purpose of video program television program, advertisement etc were not directly related to the activities of the Project and a sum of Rs. 2.01 million thereon had been reimbursed from the Loan proceeds.
- (c) The Deputy Project Director of the Project had acted as Project Director of another Project and transport allowance amounting to Rs. 90,000 and fuel allowance amounting to Rs. 56,520 for three months period of the year under review had been claimed out of the contribution received from the Government of Sri Lanka.
- (d) Even though the prior advances should be settled before obtaining another advance according to Financial Regulation No.371, the Director and the Secretary of the Project had obtained advances amounting to Rs.450,491 and Rs.425,650 during the year under review without settling previous advance.