

## **Conflict Affected Region Emergency Project (CARE)-Component - 2014**

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The audit of financial statements of the Conflict Affected Region Emergency Project Component-C 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 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 presently, the Ministry of National Policies and Economic Affairs is the Executing Agency and the Ministry of Public Administration and Home Affairs, Provincial Irrigation Department of the Northern Provincial Council and North Central Provincial Council are the Implementing Agencies of the Component-C 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 by improving basic social services. As per the Loan Agreement, the estimated total cost of the Component-C of the Project amounted to US\$ 39.06 million equivalent to Rs. 4,413.78 million and out of that, US\$ 35.27 million equivalent to Rs. 3,985.51 million was agreed to be financed by the Asian Development Bank. The Project commenced its activities on 07 June 2010 and scheduled to be completed by 30 November 2014. However, the financial statements for the year ended 31 December 2014 had been presented for audit.

### **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 misstatements 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. 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 tests 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 a satisfactory control over Project Management and the reliability of books, records etc. relating to the operation 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 operation of the Project, the identification of the purchases made out of Loan etc.
- d) Whether the opening and closing balances, withdrawals from and replenishments to the Imprest Accounts 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.
- e) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- f) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- h) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- j) Whether financial covenants laid down in the Loan Agreement had been complied with.

#### **1.5 Basis for Qualified Audit Opinion**

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

## **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, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, 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, withdrawals from and replenishments to the Imprest Accounts 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,
- 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.

## **2.2. Comments on Financial Statements**

### **2.2.1 Presentation of the Financial Statements**

According to the Circular No. MOFP/ERD/2007/2 of 07 August 2007 of the Ministry of Finance and Planning, the financial statements for the year ended 31 December 2014 required to be presented for audit before 31 March 2015. However, the financial statements for the year under review had been prepared and presented for audit only on 28 January 2016.

### **2.2.2 Accounting Deficiency**

Survey equipment valued at Rs. 2.46 million procured by a contractor, out of the proceeds of the Loan had been treated as cost of the respective contract instead of being treated as the fixed assets of the Project.

## **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 |                        | up to 31 December 2014 |                        |
|              | US\$ million                                      | Rs. million            | Rs. million  | US\$ million         | Rs. million            | US\$ million           | Rs. million            |
| ADB          | 35.27   | 3,985.51               | 1,852.00   | 20.49                | 2,648.43               | 46.58                  | 6,066.38               |
| GOSL         | 3.79  | 428.27                 | 71.50  | 2.15                 | 277.59                 | 5.97                   | 773.85                 |
| <b>Total</b> | <b><u>39.06</u></b>                               | <b><u>4,413.78</u></b> | <b><u>1,923.50</u></b>   | <b><u>22.64</u></b>  | <b><u>2,926.02</u></b> | <b><u>52.55</u></b>    | <b><u>6,840.23</u></b> |

### 3.2 Physical Progress

The Project had implemented activities on rehabilitation of 10 small and medium irrigation systems and reconstruction of the 10 public administration buildings in the Northern and North Central Provinces under the Component –C of the Project. According to the information received, 205 contracts for rehabilitation of irrigation systems administrated by the Irrigation Department of Northern Provincial Council and other 20 contracts for rehabilitation of irrigation systems administrated by the Irrigation Department of North Central Provincial Council had been completed at the end of the period of the Project. However, out of 287 small scale contracts awarded by the Ministry of Economic Development, 07 such contracts had been terminated due to delays in commencement of the contracts. Further, 33 contracts awarded for the reconstruction of public administration building had been completed at the end of the period of the Project. The following observations are made at the site visits made on rehabilitation works carried out by the Project.

- (a) At the time of inspection, it was observed that the rehabilitation works of Kalvilankulam tank in Mullaitivu District had not been done satisfactorily by the contractor. As a result, the bund of the tank was damaged at several locations as soil compaction works had not been done properly.
- (b) It was observed that rip rap protection for the bund of Udayarkaddu tank with the length of 80 metres had not been completed in proper manner. According to the explanations of the Project Director, the rip rap was provided only for critical areas of the bund due to limitation of funds allocated by the Project.
- (c) Eventhough a sum of Rs. 17.82 million had been spent for testing of soil compaction made in order to strengthen the bund of Vishvamadu tank in Mullaitivu District, the bund was badly damaged in 06 places due to improper soil compactions done. Further, it was revealed at the site visit that turfing works of the bund carried out at a cost of Rs. 286,000 was failed subsequently due to lack of proper practices for maintenance of turf during dry seasons.

- (d) It was observed that 2,238 cubic metres of rubble was estimated to be removed in order to rehabilitate the bund of Puthumurripu tank in Kilinochchi District. However, according to the information provide, only 1,229 cubic metres of rubble had been produced and no documentary evidence made available for audit to prove the actual quantity of rubble removed. According to the explanations of the Project Director, the estimation made on quantity of rubble to be removed was very much less than the estimated quantity.
  
- (e) It was revealed that the rehabilitation works of Uppalavankalappu Salt Water Exclusion Scheme in Kilinochchi District which completed by the Project at a cost of Rs.1.83 million in 2013 had not been utilized effectively for the intended purposes, as the bund of the respective tank was damaged at several places. According to the explanations of the Project Director, the subsequent maintenance works had not been carried out by the Agrarian Services Department. Further, the residents of the area had encroached the bund of the tank due to inundation of their residence at the time of floods and damaged the bund.

### **3.3 Contract Administration**

It was observed that the Project had made payments for Value Added Taxes to the contractors who engaged in civil works of the Project without verifying the validity of their registrations for Value Added Taxes. Therefore, it was observed that the Value Added Taxes aggregating Rs. 32.27 million had been paid to 28 contractors whose registrations for Value Added Taxes had remained inactive.

### **3.4 Closure of the Activities of the Project**

The Project had not taken action to wind up the accounts and prepare and present the financial statements thereon, eventhough the activities of the Project were closed as at 30 November 2014.