

Community Livelihoods in Conflict Affected Areas Project (Re - awakening Project) -2015

The audit of financial statements of the Community Livelihoods in Conflict Affected Areas Project (Re - awakening Project) for the accounting period from 01 January to 30 April 2015 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 4.01 (b) (i) of Article IV of the Development Credit Agreement No. 3935 CE dated 23 July 2004 as amended by Agreement dated 25 September 2007 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. Subsequently, the second Financing Agreement No. 4671 LK dated 11 January 2010 and the third Financing Agreement No.4956 LK dated 29 November 2011 were signed by the Democratic Socialist Republic of Sri Lanka with the International Development Association for providing additional financing for this Project.

1.2 Implementation, Objective, Funding and Duration of the Project

According to the Financing Agreements of the Project, then Ministry of Economic Development presently, the Ministry National Policy and Economic Affairs was the Implementing Agency of the Project. The objectives of the Project were to help the conflict affected communities in the Northern and Eastern Provinces and the adjoining areas to restore livelihoods, enhance agricultural and other productions and incomes and build capacity for sustainable, social and economic reintegration. As per the Financing Agreements, the estimated total cost of the Project amounted US\$ 141.14 million equivalent to Rs 16,844.42 million and out of that US\$ 124.70 million was agreed to be financed by the International Development Association. The contribution of the Government of Sri Lanka and beneficiaries of the Project amounted to US\$ 13.72 million and US\$ 2.72 million respectively. The Project commenced its activities on 23 July 2004 and scheduled to be completed by 31 December 2014. However, the date of completion of the activities of the Project had been extended up to 30 April 2015.

1.3 Responsibility of the Management for the Financial Statements

The 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 and fair presentation 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 the 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 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 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 purchases made out of the Credit etc.
- (d) Whether the opening and closing balances and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 30 April 2015 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 Credit had been made were in accordance with the specification laid down in the Financing Agreements.
- (f) Whether funds, materials and equipments supplied under the Credit had been utilized for 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 the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit and
- (j) Whether the financial covenants laid down in the Financing Agreements 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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 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 and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 30 April 2015 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 Financing Agreements,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit and
- (f) the financial covenants laid down in the Financing Agreements had been complied with.

2.2 Accounting Deficiency

The cash balance amounting to Rs.18.7 million in hands of Project Implementing Units in 09 districts and other balances amounting to Rs.297.5 million remained at Banks as at 30 April 2015 had been shown under the sub Loans granted Micro Finance Schemes of the Project without being disclosed.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provisions for the period under review and utilization of funds during the period review and up to 30 April 2015 are shown below.

Source	Amount agreed to be financed in the Loan Agreement		Allocation made in the Budget Estimate for the period under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
IDA							
Loan No							
3935	64.70	8,217.44	503	2.31	254.17	64.78	7,125.60
4671	12.00	1,400.28	-	-	-	10.36	1,351.56
4956	48.00	5,582.70	147	0.36	39.50	54.04	5,944.51
GOSL	13.72	1,372.00	75	0.36	39.53	-	1,788.91
Beneficiaries	2.72	272.00	-	-	-	-	153.55
Total	<u>141.14</u>	<u>16,844.42</u>	<u>725</u>	<u>3.03</u>	<u>333.20</u>	<u>129.18</u>	<u>16,364.13</u>

3.2 Physical Progress

According to the Financing Agreements, the activities of the Project had been implemented under the components of village rehabilitation and development activities, rehabilitation of major irrigation scheme/ minor tanks, cluster level livelihood activities and flood damage rehabilitation works. The following observations are made thereon.

- (a) It was observed that the activities of the Project had been implemented through Village Development Organizations established under the Project and continuous operations of the activities of the Project were remained doubtful as the sustainability of the Village Development Organizations were not ensured due to following reasons.
 - (i) The financial stability of the Village Development Organizations was not evaluated by the Project at the end of the period of the Project through an independent audit.
 - (ii) After the closure of the activities of the Project, the coordination and monitoring activities of the operations of the Village Development Organizations are expected to be implemented by the District Secretariats of the respective districts through Community Resource Persons who voluntarily contributed for the success of the Village Development Organizations. It was revealed at the physical observations made by the auditors at the Village Development Organizations in Padavi SriPura area, the Community Resource Persons were discouraged to devote their time for the activities of the Village Development Organizations, due to suspension of the monthly allowances ranging from Rs 7,000 to Rs 9,000 made by the Divisional Secretariats.

- (iii) According to the progress reports, 805 Village Development Organizations had been established and out of that only 723 Village Development Organizations were registered at the respective Divisional Secretariats. Further, 51 Village Development Organizations established in Trincomalee district, only 12 Village Development Organizations were registered. It was observed at the site visits, 05 Village Development Organizations were not functioned out of 09 Village Development Organizations established in the area of Padavi Sri Pura Divisional Secretariats in Trincomalee district.
- (b) The Project had implemented Micro Finance Schemes through small group participation to create self-help income generating activities in 237 focal villages. According to the information received, a sum of Rs. 1,231.05 million had been spent by the Project to grant sub loans thereon. However, the sustainability of the operations of the Micro Finance Schemes is remained doubtful due to following reasons.
 - (i) A Revolving Fund had not been established to ensure the recoverability of the sub loans granted and continue to provide loans for the same purposes, after the closure of the activities of the Project. It was observed that recovery of the installments of the sub loans is done by the Branches of the Commercial Banks in the respective areas and coordinates such activities by the Community Resource Persons, at present.
 - (ii) According to the information received, balances aggregating Rs 1,071 million of sub loans had remained outstanding as at 30 April 2015 and out of that, balances of non-performing loans aggregating Rs 188.65 million and loan losses amounting to Rs 22.23 million had remained as at that date. The test checks revealed that sub loans valued at Rs 11.70 million had been granted by 09 Village Development Societies in the area of Padavi Sripura Divisional Secretariat and out of that, the balances of sub loans valued at Rs 1.72 million had been recognized as bad debts. Further, sub loans valued at Rs 5.83 million had been granted during the period from 2011 to 2014 by 04 Village Development Societies in area of Muttur Divisional Secretariat and it was observed that the entire amount had remained unrecovered as at 30 April 2015.
- (c) According to the original plans made on 25 May 2004, the Project had expected to distribute 3,026 poly net houses to the beneficiaries of the Project and targets had been revised on 05 June 2014 up to 1,230 poly net houses as enable to reach actual achievement of distribution of 1,229 poly net houses as at 31 December 2014. According to the test checks made on the use of 04 poly net houses, out of 20 poly net houses distributed to the beneficiaries in Padavi Sripura Divisional Secretariat area, it was revealed that no such poly net houses were used for the intended purposes. Therefore, the usefulness of distribution of poly net house could not be determined in audit.

3.3 Closure of the activities of the Project

The following observations are made.

- (a) Eventhough the activities of the Project had been closed as at 30 April 2015, the handing over of fixed assets and documents had not been done properly. The duly authorized handing over lists with necessary information regarding assets including motor vehicles and motor cycles remained at the Project Implementing Units in Trincomalle, Batticloa and Mannar districts had not been made available for audit.
- (b) The financial statements had not been prepared for winding up purposes as at 30 April 2015.