

Improvement of Basic Social Services Targeting Emerging Regions Project -2016

The audit of financial statements of the Improvement of Basic Social Services Targeting Emerging Regions Project for the year ended 31 December 2016 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 Article III of Section 4 (6) of the Loan Agreement No. SLP-105 dated 28 March 2012 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Japan International Cooperation Agency (JICA).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Department of National Planning of the Ministry of Finance, presently Department of Project Management and Monitoring of the Ministry of Development Assignments is the Executing Agency and the Ministry of Health, Nutrition and Indigenous Medicine and the Eastern, North Western, Central and Sabaragamuwa Provincial Councils are the Implementing Agencies of the Project. The objectives of the Project are to improve the health, medical system and strengthen the production capacity of essential drugs through improving facilities and equipment in secondary level hospitals and the State Pharmaceutical Manufacturing Corporation, thereby contributing to the enhancement of non – communicable diseases management. As per the Loan Agreement, the estimated total cost of the Project was Japan Yen 4,760 million equivalent to Rs.6,332 million and out of that Japan Yen 3,935 million equivalent to Rs.5,155 million was agreed to be provided by the Japan International Cooperation Agency. The Project commenced its activities on 23 July 2012 and scheduled to be completed by 23 July 2019.

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 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 are selected depend on the auditor's judgment, 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 which 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 are 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 the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipment 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 satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (i) 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,

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

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

The consultancy payments aggregating Rs. 16.12 million had been understated by Rs.757,058 as the adjustments for currency fluctuations thereon was not made.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics in 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 2016 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			
	JPY million	Rs. million		Rs. million	during the year under review		as at 31 December 2016
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	3,935	5,155	839	791	997	2,454	3,014
GOSL	825	1,177	521	350	451	603	822
Total	<u>4,760</u>	<u>6,332</u>	<u>1,360</u>	<u>1,141</u>	<u>1,448</u>	<u>3,057</u>	<u>3,836</u>

3.2 Physical Progress

The following observations are made.

- (a) According to the Action Plan of the Project, it was planned to improve the capacities of Base Hospitals at Warakapola, Galgamuwa, Teldeniya and Kalawanchikudy. However, the civil construction works of Base Hospitals at Warakapola, Galgamuwa and Kalawanchikudy had not been completed and handed over to the provincial health authorities even as at 31 December 2016, eventhough it was expected to be completed by 23 November 2016. Further, the construction works of new Operation Theater Complex and Judicial Medical Unit of the Base Hospital at Theldeniya commenced on 12 February 2014 had not been completed even as at 31 December 2016 due to design failures and other administrative weaknesses.
- (b) According to the Project Documents, it was expected to strengthen the production capacity of essential drugs through improving facilities and equipment of the State Pharmaceutical Manufacturing Corporation. Therefore, the works related to development of the storage building and improvement of production capacity by modernization of machineries etc had been scheduled to be completed as at 31

December 2016 at an estimated cost of Japan Yen 1,244 million equivalent Rs.1,630 million. According to the reports on physical progress, the contracts on building construction and procurement of machineries had been awarded only on 11 January 2017.

3.3 Contract Administration

The following observations are made.

- (a) The construction works of the Base Hospital at Theldeniya had remained slow due to the failures of the Consultant deployed at the initial stages of the construction works. Therefore, the services of other Consultant had been obtained since 23 September 2016 and an additional cost of Rs.1.60 million had to be spent thereon.
- (b) It was observed that the installation of the electrical and mechanical system of the newly constructed buildings for Operation Theatre and Medical Intensive Care Unit of the Base Hospital at Theldeniya which required to be carried out with the period of construction simultaneously had not been planned and awarded as a separate contract in February 2016 at a cost of Rs. 147.03 million. However, such works were not completed even as at 31 December 2016.
- (c) The costs on passenger lift and other works aggregating Rs.17.29 million incurred for the construction of the buildings for operation theatre of Base Hospital at Theldeniya had not been included in the measurement sheets submitted on 11 February 2014 and included as the extra works and claimed on 25 February 2016.

3.4 Matters in Contentious Nature

It was observed that the rates quoted in the bid presented by the selected contractor for the constructions of Base Hospital at Theldeniya was remained higher than the Engineer's Estimate ranging was 32 per cent to 568 per cent. Thus, it indicated that the Engineer's Estimate had not been made realistically.