

Strategic Cities Development Project - 2019

The audit of financial statements of the Strategic Cities Development Project for the year ended 31 December 2019 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 II (B) (3) of the Financing Agreement No.5428-LK dated 12 September 2014 and Additional Financing Agreement No. 5800 – LK dated 20 July 2016 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. My comments and observations which I consider should be report to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement, the Ministry of then Ministry of Urban Development and Housing presently, the Ministry of Megapolis and Western Development is the Executing Agency and Urban Development Authority (UDA) is the Implementing Agency of the Project. The objectives of the Project is to improve selected urban services and public urban spaces in the Participatory City Regions of Sri Lanka. As per the Financing Agreement, the estimated total cost of the Project was US\$ 257.08 million equivalent to Rs 34,912.48 million and out of that US\$ 202 million equivalent to Rs 27,507 million was agreed to be financed by International Development Association. The balance amount of Rs 7,405.48 million is expected to be financed by the Government of Sri Lanka. The Project had commenced its activities on 05 May 2014 and scheduled to be completed by 31 December 2019. However, the date of completion of the activities of the Project had been extended up to 31 December 2021.

1.3 Opinion

In my opinion, except for the effects of the matters described in paragraph 2.1 of this report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019 and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of management and those charged with governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the project.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Accounting Deficiencies

Accounting Deficiency -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
Provision for compensation payable on land acquisition amounting to Rs. 13.41 million as at 31 December 2019 had not been made in the financial statements.	Understatement of payables in the financial statements.	No Provision has been made in the financial Statements.	The value of the payables as at end of the year should be shown in the financial statements.

3. Physical Performance

3.1 Physical progress of the activities of the Project

The Urban infrastructure development activities of the Participatory City Regions of Kandy, Galle and Jaffna here been implemented by the Project and the following observation are made thereon.

Component	Activity	Audit Issue	Impact	Reason for Delays	Response of the Management	Auditor's Recommendation
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(a) Kandy city Region Urban Interventions	Rehabilitation and improvement of Kandy madawala Road	The contract for rehabilitation of Kandy Madawala Road had been commenced on 07 July 2016 at an estimated cost of Rs.1,614.96 million (US\$ 10.77) Subsequently the construction works had been suspended on 06 September 2017 with financial and physical progress of 24 per cent and 14 per cent respectively and a sum of Rs.392.73 million (US\$ 2.62 million) had been incurred up to the date of suspension and a sum of Rs.28.16 million had been incurred by the Project for remedial actions. Further,	The time schedules, cost of the Project will over run.	Failure to evaluate the financial and physical capacities of the Contractor before the selection.	Due to poor performance of the contractor, contract was terminated on 06 Sep 2017, at the termination Physical progress was 14.62% and Plan Progress was 53.14%. After termination of above contract, KMD road maintenance work was handed over to Road Development Authority (RDA) until next contractor commences the balance work.	Sound and effective project management system should be implemented in order to achieve the project objectives.

the tender for the contract had not been called again up to end of the year under review even after lapse of 2 years and 3 months. As a result, the expected results could not be achieved by the Project.

(b)	Rehabilitation of Kandy Multimode Transport Terminal	Financing for the construction work of Kandy Multimode Transport Terminal at a cost of Rs.10,500 million (US\$ 65 million) had been suspended by International Development Association, due to the lack of adequate time period to complete the construction works within the Project period even after incurring of Rs.247.19 million. Further, Project had made payment of Rs. 605.40 million as the compensation under Resettlement Action Plan.	Due to Management failures entire project objectives could not be achieved and it may be wasting the project funds.	Delays in Resettlement and Design activities	Agreed. Now the WB has decided to implement KMTT as a separate project with the consultation with ministry and ERD	Sound and effective project management system should be implemented in order to achieve the project objectives.
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(c)	Rehabilitation of Kandy Dharmashoka Road	The contract for the construction of Kandy Dharmashoka road had been commenced on 07 July 2016 at an estimated cost of Rs.796.43 million (US\$ 5.31 million) and scheduled to be completed during the year under review. However, the contract terminated on 14 June 2019 due to poor performance of the contractor. The financial and physical performance of the contract as at that date were 66 per cent and 25 per cent respectively.	Due to delay in Constructions, Costs could be increased and duration of the Project has to be extended.	Failure to evaluate the financial and physical capacities of the contractor	Achieved Physical Progress of the sub-project was far behind the plan physical progress due to lack of resources, then showed contractor's delays with their faults and advised to catch up delays in each month.	Sound and effective project management system should be implemented in order to achieve the project objectives.	
(d)	Galle city Region Urban Interventions	Improvement of water retention Areas and flood control drainages systems	The consultancy firm had identified 8 locations as flood control points located along the Moragoda cannal banks. The Project had failed to acquire the required lands to develop those locations as water retention areas in order to prepare a plan for the Wetland Management. Due to the lack of proper	The expected outcome of the project component may not achieve due to improper project management.	Lack of proper coordination between the respective public authorities in Galle	Galle drainage improvement intervention had to be changed after consultation with relevant stakeholders' agencies and practical difficulties in implementation of required development due to social and land acquisition issues which may prevent achieving the set target within the available time frame.	Land acquisition activities should be carried out keeping proper coordination with the respective other government institutes. The identified public needs should be fulfilled implementing

coordination between the respective public authorities in the area the land acquisition activities had been suspended. Due to the land acquisition issues the construction works of 16 flood control drainage systems in the city of Galle had not been commenced. This situation had been directly affected to achievement of objectives of the Project.

efficient Project Management System.

3.2 Contract Administration

The following observation are made

Audit Issue	Impact	Response of the Management	Auditor's Recommendation
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(a) Even after lapsed of 5 years of the commencement of the Project activities, only 201 contracts for constructions, goods and consultancies valued at US\$ 190.57 million had been identified. According to the Project Agreement, 21 sub – projects valued at US\$ 91.94 million were under preparation, representing 45 per cent of the total contract value. Further, the construction works of 117 contracts valued at US\$ 21.37	Due to delay in Constructions, Construction costs could be increased and duration of the Project has to be extended.	The SCDP has to deal with stake holder agencies and relevant government authorities in selecting relevant Contracts to be awarded for Consultancy services and for Works. Due to unforeseen difficulties, selection of contracts have got delayed.	After being evaluated the current Progress, corrective actions should be taken to expedite the remaining construction works.

million the year under review representing low progress of 11 per cent compared to the total cost of the Project. Out of the total identified contracts, 7 contracts valued at US\$ 4.43 million were at the procurement stage.

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| <p>(b) Five firms had furnished the bids for the rehabilitation of Moragoda Ela – Main Canal contract that scheduled to be carried out at an estimated cost of Rs.1,452.13 million. The lowest bidder who had submitted the bid for Rs.844.90 million, had been rejected by the TEC, due to the significant price variations. Hence, the second lowest bidder had been selected. However, without being adhered to that decision, the rejected bidder had been selected reducing the original estimate of the contract up to Rs.1,039.11 million without having the consent of the consultants. So as the contract had been awarded in the year 2017 to complete the construction works by 2019. However, due to poor performance of the contractor the contract had been terminated on 11 April 2019 after being incurred Rs.339 million.</p> | <p>Completion time of the contract had to be extend and as a result it will affected to the overall time schedules of the Project.</p> | <p>The Engineers Estimate was revised as per the Instructions received from the SCAPC and based on this revised Estimate, the lowest bid was accepted by the SCAPC.</p> | <p>Price analysis of the BOQ items should be conducted before commencing the bidding activities.</p> |
| <p>(c) In order to finalize the remaining works of the above contract within 15 months the contract had awarded to the Sri Lanka Land Development Corporation for Rs.736.02</p> | <p>This situation had caused to violate the government procurement guidelines and such actions lead to misuse the public</p> | <p>Engineers Estimate is revised taking in to consideration the price escalations the difference between rates of SLLDC and revised Engineers Estimate is not</p> | <p>Reliable and realistic estimate should be prepared for the contracts and Price analysis of the BOQ items should be done before awarding the</p> |

million on 17 June 2019 on direct basis without calling bids. However, according to the Engineer's estimate, the value of the remaining works only Rs.463.08 million. Thus, it was observed that the contract had been awarded by exceeding Rs.272.94 million over the estimated value. Further, the quoted prices by the Corporation for some of the BOQ items were exceeded by 100 per cent. In this connection a rate analysis thereon had not been conducted by the Project.

funds and Project cost may be that significant.
over run

contracts.

(c) In terms of Section 3.5 (e) of the Government Procurement Guidelines, the direct contract method cannot be awarded without being obtained the approval of the Cabinet of Ministers. The contract of balance works of slope stabilization with soil anchoring on Dharmashoka Mawatha in Kandy had been awarded for Rs.156.62 million during the year under review without being followed the above regulations. Further, although the Engineer's estimate of the contract amounted to Rs.116.60 million, the contract had been awarded exceeding the estimated cost by Rs.40.02 million.

Over estimate will lead to conduct corruption as well it will affect to cost effectiveness of the project

The procurement procedure followed in awarding this works contract is correct and PPC has the authority to award this contract.

Accurate and reliable cost estimate should be prepared and the cost estimate should be rational.

(e) The mobilization advances given to the contractor by the project as at end of the year under review amounted to Rs.1,350 million. Out of those advances, a sum of Rs.608.49

This situation has violated the government regulation and such action may lead to fraud and misused of public funds.

As per the provisions in the Contract Agreement the recover cannot start until contractor achieves 30% progress of the Contract Value

Prompt actions should be taken to recover the advances according to the agreements.

million had not been recovered for over 3 years. The project had not taken adequate action to recover the advances and due to that reason, the project funds that had been given under the loan had been kept by the contractors for long period of time without having reasonable reasons to do so.

3.3 Idle and Underutilized Resource

Audit Issue	Impact	Response of the Management	Auditor’s Recommendation
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<p>According to the information received, only a sum of US\$ 55.05 million equivalent to Rs.9,012.71 million representing 27 per cent of the total allocation of US\$ 202 million equivalent to Rs. 27,507 million made by the Lending Agency had been utilized as at 31 December 2019, even after lapse of 5 ½ years from the commencement of the activities of the Project. Further,the balance of US\$ 4.39 million equivalent to Rs.797.85 million had been remained in the Special (Dollar) Account without being utilized by the Project as at 31 December 2019, due to slow progress of the activities of the Project and poor financial forecasting.</p>	<p>The activities of the project could not be completed during the scheduled time period of the project</p>	<p>Agreed with the comments made on utilization of the funds. However the reason for the slow progress will not impact comprehensive action plan covering the entire project period.</p>	<p>Action should be taken to monitor the Action plans with the actual performance in order to take remedial actions in timely manner and make use the allocated funds in full.</p>

3.4 Issue Related to Human Resources Management

Eventhough the approved cadre of the Project consisted with 140 various categories of the posts, actions had not been taken to fill the 43 vacant posts including 12 key posts of Deputy Project Directors, Senior Engineers and 16 Assistant Project Director over 03 years. It was further observed that 78 Project officers had been left from the service since the year 2014. The above mentioned shortages of staff had mainly influenced for the slow progress of the Project.

3.5 Systems and Controls

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
Even though the Project had scheduled to implement 11 procurements at an estimated cost of Rs.3,761 million during the year under review those procurements had not been made according to the plan.	Completion time of the project had to be extend as a result of delaying the project functions.	Some procurement activities have been replaced and some other works is in progress.	Action should be taken to carry out the scheduled procurement activities in timely manner.

3.6 Matters in Contentious Nature

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
According to the agreements entered by the Project on hiring of motor vehicles of maximum limit of 2500 kilometers per month is required to be run and additional charges are needed to be paid for excess kilometers. It was observed that a sum of	Possible to misuse of the motor vehicles	Action will be taken to minimize the losses and misuses.	Need to ensure the economy, efficiency and effectiveness of the use of fleet of motor vehicles and their costs.

Rs.4.72 million had been spent by the Project on running of 90,855 kilometers in excess without exceeding maximum limit of 2500 Kilometers. Further the project had not called bids for the year under review and used services from two rent vehicle owner companies which are selected in previous year.