

Strategic Cities Development Project - 2018

The audit of financial statements of the Strategic Cities Development Project for the year ended 31 December 2018 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 reported to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreements, then Ministry of Urban Development Water Supply and Drainage, presently the Ministry of Urban Development, Water Supply and Housing Facilities is the Executing Agency and the Urban Development Authority is the Implementing Agency of the Project. The objectives of the Project are to improve selected urban services and public urban spaces in the Participatory City Regions of Sri Lanka. As per the Financing Agreements, the estimated total cost of the Project amounted to 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 the 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 the Table 2 of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2018, financial performance 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.

In preparing the financial statements, management is responsible for assessing the Project's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

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
A sum of Rs.13.5 million retained by the Project out of the payments made on compensation for acquisition of properties had not been shown in the financial statements.	Understatement of the payables.	Applied consistently on accrual basis except implementation support expenses.	The payable on retention money at the end of the year need to be brought to account.

2.2 Non-compliance with Laws, Rules and Regulations

Reference to the Laws Rules and Regulations	Non- compliance	Impact	Response of the Management	Auditor's Recommendation
Section II of the Financing Agreement	Local Taxes amounting to Rs.1.31 million had been paid out of the proceeds of the Loan during the year under review.	Overstatement of loan fund	Necessary action will be taken to transfer Nation's Building Tax payment to the government funds in this year.	Project Finance Agreement and Guidelines should be followed.

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 are scheduled to be implemented by the Project and the following observations are made thereon.

Component	Activity	Audit Issue	Impact	Reason for Delays	Response of the Management	Auditor's Recommendations
Kandy Region Interventions	City Urban Rehabilitation and Improvements of section of Katugastota - Madawala - Digana Road	The contract for rehabilitation of the Road had been awarded at an estimated cost of US\$ 10.77 million equivalent to Rs.1,614.96 million and commenced on 07 July 2016 had been suspended on 06 September 2017 after incurring a cost of US\$ 2.62 million equivalent to Rs.392.73 million. The balance of mobilization advance amounting to Rs. 242.24 million remained outstanding at end of the year under review.	The period of the contract had to be extended and it will affected to the overall time schedules of the Project.	Failure to evaluate the financial and physical capacities of the contractor.	Not responded.	Sound and efficient contract management system need to be implemented on monitoring and supervision of the works carried out by the contractors.
	Rehabilitation and Improvements of Dharmasoka Mawatha	The reconstruction works of the Road commenced on 07 July 2016 and scheduled to be completed at the end of the year under review had shown slow progress of 45 per cent as at that date.	Possible delays in completion of reconstruction works.	Failures of the contractors and several social issues.	Not responded	- Do -

Rehabilitation of Meda Ela	The contract on rehabilitation of Kandy Meda- ella scheduled to be completed by 17 July 2017 had shown slow physical progress of 68 per cent as at 31 December 2018 and terminated on 31 May 2018. At the time of termination of the contract, a sum of Rs.133.75 million had been incurred thereon.	Possibility to incur additional costs.	Change of the scope of works and lack of a proper supervision.	The contract had been terminated on 31 May 2018 and the site was handed over by the Contractor on 19 July 2018.	- Do -
Rehabilitation of underground storm water drainage system in Kandy City	The rehabilitation works of underground drainage Tunnel in Kandy City awarded at an estimated cost of Rs.1,016 million had been commenced on 25 April 2018 and the expected physical progress as at 31 December 2018 was remained at 25 per cent. However, actual physical progress was remained at 4 per cent only.	Possibility extend the period of contract.	Adequate work force had not been deployed.	The contractor had not deployed required key staff and machineries at the initial stage.	- Do -
Improvement of Tomlin Park in Kandy	Eventhough it was expected to achieve 27 per cent physical progress as at 31 December 2018 only a 10 per cent of physical progress had been achieved as at that date.	- Do -	Due to design failures.	The Consultant had to resubmit the revised designs and drawings to the contractor.	- Do -
Improvement of Municipal car park Roof Top	The physical progress on improvement works was reported as 29 per cent, eventhough it was targeted to achieve	Possible delays in completion of the works and losses	Delays in shifting of existing shops at the ground	Action will be taken to expediate the	Prompt action need to be catch up the delays.

47 per cent of progress as the end of the year under review. on additional floor of the works. claims of the building. contractors.

Galle Region Interventions	City Urban	Reconstruction of Kahathuduwa Bridge across Moragoda Ela at Galle-Baddegama Road	The contract for reconstruction of the Bridge had been terminated, due to the slow progress of works, after incurring of Rs.22.4 million, out of the estimated cost of Rs.54.5 million.	Possibility to incur additional costs.	Lack of a proper supervision over the works of the contractors.	Not responded.	Corrective actions need to be taken to complete the remaining works.
		Rehabilitation of Moragoda Ela-main canal and Temple by pass	Eventhough the physical progress of the rehabilitation of Moragoda Ela – main cannel was expected to reach at 65 per cent as at 31 December 2018, the actual progress was remained at 19 per cent as at that date.	Possibility to extend the period of the contract.	Poor performance of the contractor and lack of construction supervision.	The physical progress was remained below the expected level, due to poor contractor performance.	Need to supervise the activities of the contractor in effective manner.

3.2 Contract Administration

The following observations are made.

	Audit Issue	Impact	Response of the Management	Auditor's Recommendations
(a)	Out of the total mobilization advances aggregating Rs. 1,237 million granted to the contractors, a sum of Rs 161.50 million had remained outstanding over 03 years. The Project had not taken adequate action to recover the advances, allowing contractor to obtain additional financial gains.	Possibility to misuse public fund or engage in fraudulent activities.	Mobilization advance of Rs.161.5 million to be received from the terminated contractor. However, all these advances will be recovered through bank guarantee.	The contractor should be enforced to settle the advance as early as possible.

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| (b) | Although the contract for the rehabilitation of Arthar's Seat viewing desk had been completed at a cost Rs.24.22 million, it was revealed at the site visit that the electricity supply for the location was not provided as the electrical accessories fixed at the premises had been destroyed by unknown group. | Expected outcome of the Project will not be reached to the stakeholders. | Action will be taken to fix the respective electrical fittings. | The security of the location need to be strengthen. |
| (c) | It was observed that 26 sub projects scheduled to be carried out during the year under review at an estimated cost of Rs.1,333 million had not been commenced even as at 31 December 2018. | Possible extension of the period of the Project. | The respective sub projects will be implemented subsequently. | Need to be adhere with the Action Plans. |
| (d) | It was observed that the construction works of Kandy Multimode Transport Terminal and construction of Gatabe Water purification Plant scheduled to be carried out at an estimated costs of Rs.9,316.60 million and Rs.899 million respectively had been suspended during the year under review. | Intended benefits of the Project will not be reached to the stakeholders. | Action will be taken to recommence the works. | - Do -. |
| (e) | Eventhough a sum of Rs.144 million had been allocated for the consultancy services of Jaffna City Development purposes, action had not been taken to obtain necessary consulting services even up to end of the year under review. Further, although a sum of Rs. 5.8 million had been allocated for contract facilitating activities of the proposed development activities in Jaffna | - Do - | The works of Design Consultant had not been commenced until the business plan is completed. | - Do - |

peninsula, respective activities had also not been conducted.

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| (f) | The final consultancy report of the Urban Updating Invention in Galle scheduled to be submitted on 27 April 2017 had not been submitted even as at end of the year under review, eventhough the advances amounting to Rs.61.36 million had been released. In addition, 11 other Consultants had been recruited to complete the several parts of the respective consultancy service and a sum of Rs.15.81 million had also been paid for the Consultants. As a result of the delays in completion of the consultancy services, the works under the contract of the Urban Updating Invention in Galle had been remained slow. | The period of the contract would be extended and possible overrunning of costs. | Agreed. | - Do -. |
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3.3 Idle and Underutilized Resources

The following observations are made.

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
(a) The machineries and equipment procured during the year under review at a cost of Rs.278.67 million handed over to the Municipal Councils of Kandy and Galle and the Department of Irrigation for the use of maintenance activities had remained at the said premises without being utilized, due to lack of assets utilization plan. Further, pipes and accessories procured in 2016 at a cost of Rs.120 million had not been used up to end of the year under review and kept in idle at the premises of the Water Supply and Drainage Board.	Possible damages and unauthorize uses of the machines and equipment.	The machineries and equipment supplied to Department of Irrigation and Kandy Municipal Council are utilized in their routine works.	A sound assets management system needs to be introduced as part of the financial management system.

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| <p>(b) The construction works of 03 water tanks, laying of piles and fixing of water pumps had been completed in 2016 at a cost of Rs.76.5 million to provide water supply facilities for 300 families in Heerasgala and Dangolla in Kandy. However, the water supply facilities had not been provided even up to 31 May 2019.</p> | <p>The intended benefits would not be received to the stakeholders.</p> | <p>The Pump House was handed over to Kandy Municipal Council on 02 May 2019 and now in functioning.</p> | <p>The reasons for delays need to be investigated.</p> |
| <p>(c) A sum of US\$ 36.28 million equivalent to Rs.5,638.31 million representing 18 per cent of the total allocation of US\$ 202 million equivalent to Rs. 27,507 million made by the Leading Agency had only been utilized as at 31 December 2018 after lapse of 4 ½ years from the commencement of the activities of the Project. Further, out of the total allocation of US\$ 5.37 million equivalent to Rs.1000 million made to the Jaffna City Development Project for the year under review, only US\$ 1.40 million equivalent to Rs.244.26 million had been utilized as at 31 December 2018, due to the lack of a proper work plan for land acquisition and resettlement purposes.</p> | <p>The activities of the Project could not be completed during the scheduled period of the Project.</p> | <p>The progress of the Project was remained slow in first 2 ½ years, due to prevailed political changes in the country.</p> | <p>Need to complete the activities of the Project during the scheduled period and make use allocated fund in full.</p> |

3.4 Issues Related to Human Resources Management

Eventhough the approved cadre of the Project consisted with 194 of officers, actions had not been taken to fill the vacancies remained in 71 officers including the officers for 09 key posts of Additional Project Director, Deputy Project Directors and Assistant Project Director over 02 years as at 31 December 2018. The above mentioned shortages of staff had influenced mainly for the slow progress of implementing of the activities of the Project.

3.5 Systems and controls

The following observations are made.

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
(a) The Project had cancelled 12 procurement activities during the year under review at the estimated cost of US\$ 79.94 million. Further, 21 contracts on consultancy activities during the year under review at an estimated cost of US\$ 10.37 million had also been cancelled.	It will affect to the expected results and outcome of the Project.	Some procurement activities have been replaced and some other works cannot be carried out, due to the ongoing Greater Kandy Sewerage Project.	Subsequent plans should be implemented according to the Project activities.
(b) The detailed budget for the year under review based on the work schedule of the Project, as required by the Paragraph 11 of the Project Appraisal Document had not been prepared. Therefore, a sum of Rs.2,746 million had only been utilized, out of the allocation amounting to Rs.5,100 million made in the Budget Estimate for the year under review.	Weaken controls on Project financial management and the period of the Project also may be extended.	Due to abandonment of the activities scheduled to be implemented in Galle respective savings were occurred.	Project activities should be effectively planned and designed.
(c) It was observed that only US\$ 13.12 million equivalent to Rs.2,206.51 million had been withdrawn during the year under review from the Special (Doller) Account maintained at the Central Bank of Sri Lanka, out of the credit balance of US\$ 16.49 million equivalent to Rs.2,473.50 million remained in the respective Account including the balance of US\$ 4.23 million equivalent of Rs.647.35 remained as at 01 January 2018 and the imprest of US\$ 18.80 million equivalent to Rs.2,939.46 million made in the year 2018. Therefore, the balance of US\$ 9.84 million equivalent to Rs.1,799.21 million had remained unused in the Account as at 31 December 2018, due to slow progress	Poor planning on utilization of funds allocated by the Lending Agency.	Due to delays in implementation of activities planned, the allocated funds was not effectively utilized.	Proper mechanism need to be established to utilize the funds in effective manner.

of the activities of the Project and poor forecasting of financial needs.

3.6 Matters in Contentious Nature

The following observations are made.

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
(a) The effectiveness in use of motor vehicles hired by the Project and allocated to the different Sections of the Project could not be evaluated in audit , as the fleet of motor vehicles was operated without being supervised by a Transport Officer. According to the agreements entered by the Project on hiring of motor vehicles, maximum limit of 2500 kilometres per month is required to be run and additional charges is needed to be paid for excess kilometres. It was observed that a sum of Rs. 7.15 million had been spent by the Project on running of 118,283 kilometres in excess while several other motor vehicles had performed below the maximum limit of 94,177 kilometres. Further, the motor vehicles hired by the Project had been allocated to each of the Divisions. As those motor vehicles had been operated without having the supervision of a transport officer, use of the motor vehicles in effective manner could not be ruled out in audit.	Possible to misuse of the motor vehicles.	Action will be taken to minimize the losses and misuses.	Need to ensure the efficiency and effectiveness of the use of fleet of motor vehicles .

(b) A motor vehicle hired by the Project had been released to the Line Ministry and a sum of Rs.2.22 million had been paid as hiring charges for those motor vehicles during the year under review.

- Do -

The motor vehicle had been provided for media/coordination work of the Ministry on their request.

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3.7 Lands Acquisition

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
<p>Out of the total cost of compensation on land acquired amounting Rs.224.92 million, only a sum of Rs.77.37 million had been paid as the statutory payments to be made under the Section 17 of Land Acquisition Act. The balance amount of Rs.147.55 million had been paid based on the recommendations of the Land Acquisition Resettlement Committee.</p>	<p>Possible corruptions and frauds relating to the payments.</p>	<p>The compensations are paid for the affected persons of Land acquisition based on the legal framework and considering the agreed social safeguard policies of the Government of Sri Lanka.</p>	<p>The records on additional payments need to be maintained in order to justify the reasonableness of the payments.</p>