

Conflict Affected Region Emergency (CARE) Component Project -A- 2014

The audit of financial statements of the Conflict Affected Region Emergency (CARE) – Component-A Project 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 and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Economic Development, presently the Ministry of National Policies and Economic Affairs is the Executing Agency and the Northern Province Council North Central Provincial Council and the Road Development Authority are the Implementing Agencies 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. As per the Loan Agreement, the estimated total cost of Component “A” of the Project amounted to US\$ 69.59 million equivalent to Rs. 8,992.42 million and out of that US\$ 61.95 million equivalent to Rs. 8,005.18 million was agreed to be financed by Asian Development Bank. The activities of the Project commenced on 07 June 2010 and scheduled to be completed by 30 June 2013. However, the date of completion of the activities of the Project had been extended up to 31 December 2014.

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 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 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 include 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 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 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 identifications 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 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 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 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,

- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) 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/20007/2 of 07 August 2007 of the Ministry of Financing 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 Non - Compliance with Laws, Rules and Regulations

The following instances of non-compliances are observed in audit.

- (a) Remuneration aggregating Rs. 11.17 million had been paid during the year under review to the employees of the Road Development Authority attached to the Project, based on the formula introduced by the Road Development Authority, contrary to the instructions of the Circular No.33 of 05 April 2007 of the Department of Management Services.
- (b) Although the employees of the Road Development Authority attached to the Project are not entitled for other allowances in terms of paragraph 5.4 of the Circular No. 33 of 05 April 2007, a sum of Rs.240,685 had been paid by the Project as reimbursements of medical claims.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing 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		<u>Funds utilized</u>			
			during the year 2014		up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	61.95	8,005.18	14.26	1,842.73	61.37	7,930.06
GOSL	7.64	987.24	1.45	186.76	6.63	856.37
	<u>69.59</u>	<u>8,992.42</u>	<u>15.71</u>	<u>2,029.49</u>	<u>68.00</u>	<u>8,786.43</u>

3.2 Physical Progress

It was observed that 265 kilometres of provincial roads in the Northern Province and North Central Province were expected to be rehabilitated under 39 contracts packages during the period of the Project. Out of that, the rehabilitation works of provincial roads under 37 contract packages had been completed as at 31 December 2014. Further, the rehabilitation works under 27 contract packages had been completed with delays ranging from 01 month to 16 months.

3.3 Contract Administration

The following observations are made.

- (a) As a practice, the variations of the scope of works are approved by the officers of the respective local authorities or the Project Director. Therefore, variations aggregating Rs. 13 million over the estimated cost of the road rehabilitation works of the North Central Province under 04 road packages and the other variations aggregating Rs. 828 million over the estimated cost of the rehabilitation works of 33 road packages in the Northern Province had not been approved by the authorized parties.
- (b) Further, the extension of time ranging from 243 days to 445 days over the originally agreed period of completion on rehabilitation of 05 provincial roads in the Northern Province had been granted by the Project Director without valid reasons, contrary to the paragraph 8.14.1 of the Government Procurement Guidelines.

- (c) It was observed that 02 roads rehabilitated by the Project had been taken over by the Provincial Road Development Department of the Northern Provincial Council with delays over 200 days, contrary to the Clause 10 of the Condition of Contract which required to be handed over within 07 days of the completion of the road rehabilitation works.
- (d) The site visits made by the auditors from 16 to 28 of March 2016 had inspected the cracks in the road surfaces in several locations of Mankulam - Vellankulam Road, Akkarayankulam - Vannerikulam Road and Kokavil - Thunukkai Road due to quality failures of the road rehabilitation works carried out. Further, chevron road sign boards fixed at the sides of Thunukkai to Thenniyam Road were not properly fixed to ensure the safety rides of the Road.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) According to the consultancy agreement, the original documents handled by the Consultants should be handed over to the Project, after completion of the contract. However, the correspondence files and original documents related to the completed works of the Project had not been handed over by the Consultants even though the Project Director had made several requests thereon.
- (b) Buildings for the quarters in Vavuniya and Kilinochchi of the Provincial Road Development Authority had been renovated at a cost of Rs. 4.2 million by the Project even though such renovation works were not included in the scope of the road rehabilitation works.
- (c) It was revealed in audit that the Value Added Taxes amounting Rs. 17.78 million had been paid by the Project to 04 contractors whose Value Added Tax registrations were remained invalid.

4. Closure of the Activities of the Project

Even though the activities of the Project had been closed as at 31 December 2014, action had not been taken by the Project and the Executing Agency to hand over the inventory items to the respective agencies, after making a physical verifications and prepare windup accounts and Project Completion Reports as at 31 December 2014.