

Conflict-Affected Region Emergency Project – Component “B” - 2014

The audit of financial statements of the Conflict-Affected Region Emergency Project – Component “B” 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 Section 4.05 (a) of Article IV of the Loan Agreement No. 2626 – SRI dated 07 June 2010 and Section 4.03 (a) of Article IV of the Grant Agreement No. 0246-SRI dated 11 August 2011 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Agreements of the Conflict-Affected Region Emergency Project, then Ministry of Economic Development, presently the Ministry of National Policies and Economic Affairs is the Executing Agency and Ceylon Electricity Board, National Water Supply and Drainage Board and the Project Coordination and Quality Assurance Unit are the Implementing Agencies of the Component “B” 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 by restoring basic utilities. As per the Agreements, the reallocated total cost of the Component “B” amounted US\$ 31.17 million and out of that US\$ 26.29 million or 84 per cent agreed to be financed by the Asian Development Bank as a Loan and US\$ 1.50 million for civil works under National Water Supply and Drainage Board as a Grant. The Project commenced its activities on 07 June 2010 and scheduled to be completed by 30 September 2014. However, the financial statements for the year ended 31 December 2014 had been presented for audit.

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 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 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 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 identification of the purchases made out of the Loan and Grant etc.
- (d) Whether the withdrawals under the Loan and Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements.
- (e) Whether the funds, materials and equipment supplied under the Loan and Grant 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 financial covenants laid down in the Loan and Grant 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 2014 and the financial statements give a true and fair view of the state of affairs of the Project as a 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 and Grant Agreements.
- (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 and Grant Agreements 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/2007/2 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 Lack of Documentary Evidence for Audit

As stated in the financial statements, the unspent cash balance of Rs. 7.38 million retained at the National Water Supply and Drainage Board had been refunded to the Project Monitoring Unit as at 31 December 2014. However, no evidence had been received for audit to confirm the balance refunded.

2.2.3 Payables

Action had not been taken even at the end of the period of the Project to release the retention money aggregating Rs. 10.95 million on 02 construction works carried out under the Grant and completed in 2013.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics in relating to the financing, budgetary provisions for the year under review 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 and Grant Agreements		Allocation made in the Budget Estimate for the year 2014	<u>Funds utilized</u>			
				during the year 2014		up to 31 December 2014	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB							
- Loan	26.29	3,437.42	2,178.95	10.87	1,413.70	25.19	3,275.54
- Grant	1.50	196.13	-	-	-	1.40	180.81
GOSL	3.38	442.59	544.80	0.93	120.90	1.69	219.73
Total	<u>31.17</u>	<u>4,076.14</u>	<u>2,723.75</u>	<u>11.80</u>	<u>1,534.60</u>	<u>28.28</u>	<u>3,676.08</u>

The following observations are made.

- According to the information received out of the total allocation of US\$ 31.17 million equivalent to Rs. 4,076 million for the Component – B of the Project US\$ 28.28 million equivalent to Rs. 3,676 million representing 90 per cent had been utilized at the end of the period of the Project. It was further observed that the allocations of US\$ 15.47million equivalent to Rs. 2,022.7 million and US\$ 9.66 million equivalent to Rs. 1,263.04 million had been made for the civil works of the Ceylon Electricity Board and National Water Supply and Drainage Board respectively and out of that only of US\$ 12.37 million equivalent to Rs.1,595.73 million and US\$ 7.62 million equivalent to Rs.991.02 million respectively had been utilized for the intended purposes.

- (b) It was observed that the reimbursement applications valued at US\$ 4.64 million equivalent to Rs. 604.34 million had been withheld at the end of the year under review. Further, the commitment charges of US\$ 314,740 equivalent to Rs. 24.89 million had been recovered by the Lending Agency as at 31 December 2014 on unutilized allocation of funds.

3.2 Physical Progress

The following observations are made.

- (a) According to the information received, the restoration of electricity transmission line in Jaffna Peninsula which expected to be completed by June 2012 had been completed only on September 2014. Further, only 120,000 houses were provided electricity connections as at 31 December 2014, out of 160,000 houses expected to be provided electricity connections.
- (b) The construction works of water supply schemes of Point Pedro in the Northern Province and Eachalampattu of the Eastern Province implemented by the Project had been completed in September 2014 with delays of 18 months and 12 months respectively due to late commencement of construction works.

3.3 Extraneous Activities

The following observations are made.

- (a) A sum of Rs. 625.03 million had been spent by the Project Coordination and Quality Assurance Unit for the purpose of small irrigation works was not directly related to the activities of the Project.
- (b) The office equipment valued at Rs. 67,863 lost in 2011 had been continuously shown under the current assets of the Project without taking action to recognize the responsible parties and recover the loss.

3.4 Closure of the Activities of the Project

The activities of the Project had been closed as at 30 September 2014 and all eligible expenses had also been claimed and withdrawn before 31 December 2015. However, the Project Completion Report had not been submitted by the Consultants even as at 30 April 2016. According to the information received, 28 items of fixed assets only, out of 224 items of fixed assets had been handed over to the Implementing Agencies as at 31 December 2015. Further, the action had not been taken by the Project Executing Agency to hand over the rest of the assets to the respective parties and prepare wind up accounts.