

Local Government Enhancement Sector Project (Pura Neguma) -2013.

The audit of financial statements of the Local Government Enhancement Sector Project (Pura Neguma) for the year ended 31 December 2013 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 4.02 of Article IV of the Loan Agreement No 2790-SRI(SF) dated 21 October 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 Loan Agreement of the Local Government Enhancement Sector Project (Pura Neguma), the Ministry of Local Government and Provincial Councils is the Executing Agency and the Provincial Councils in the seven Provinces are the Implementing Agencies of the Project. The main objective of the Project is to achieve improved local government infrastructure and effective delivery of services through accountable, and financially and technically strengthened local authorities. As per the Loan Agreement, the estimated total cost of the Project was US\$ 68.8 million and out of that US\$ 59 million was agreed to be financed by the Asian Development Bank. The Project commenced its activities on 01 July 2012 and was scheduled to be completed by 30 June 2015. Subsequently, the Project Period had been extended up to 31 December 2016.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

2. Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records 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 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 purchases made out of the Loan etc,
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (d) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project,
- (e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles,
- (g) Whether the opening and closing balances, withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,
- (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.

3. 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 5 of this report, I am of opinion that;

- (a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances, the withdrawals from and replenishments to the Imprest Fund Account during the year ended 31 December 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,

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

4. Financial Statements

4.1 Financial Performance

According to the financial statements and information made available, the expenditure of the Project for the year ended 31 December 2013 amounted to Rs.321,601,820 and cumulative expenditure as at 31 December 2013 amounted to Rs. 337,373,655. A summary of the expenditure for the year under review, expenditure for the first accounting period from 01 July to 31 December 2012 and the cumulative expenditure as at 31 December 2013 are given below.

Item of Expenditure	Expenditure for the year ended 31 December 2013	Expenditure for the first accounting period from 01 July to 31 December 2012	Cumulative expenditure as at 31 December 2013
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	Rs.	Rs.	Rs.
Civil Works and Equipment	140,721,981	-	140,721,981
Consultancy Services	89,558,874	7,293,093	96,851,967
Property, Plant and Equipment	574,948	73,095	648,043
Interest	960,887	236,287	1,197,174
Operational Cost	89,785,130	8,169,360	97,954,490
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Total	321,601,820	15,771,835	337,373,655
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4.2 Imprest Fund Account

According to the financial statements and information made available, the operations of the Imprest Fund Account for the year ended 31 December 2013 and the balance remained as at 31 December 2013 are given below.

US\$

Rs.

Balance as at 01 January 2013	120,848.56	15,367,200
<u>Add</u>		
Replenishments	2,900,818.80	379,746,568
Revaluation Gain	-	470,855
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<u>Less</u>		
Withdrawals	3,021,667.36	395,584,623
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Balance as at 31 December 2013	1,253,135.19	163,851,186
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5. Audit Observations

5.1 Presentation of the Financial Statements

According to the Section 5(d) of the Project Administration Manual, the audited annual financial statement should be furnished to the Lending Agency within 09 months at the end of the financial year. However, the draft financial statement of the Project for the year ended 31 December 2013 had been furnished for audit only on 07 July 2014.

5.2 Accounting Deficiencies

The following observations are made.

- (a) According to the arrangement of the Project, the Sub Project Coordinating Units established in the seven Provinces are responsible for implementing the project activities and maintaining of separated records for accounting and administrative purpose. However, instances were observed in audit that some of the Sub Project Coordinating Units had not maintained records adequately to identify the financial and other resources allocated and expenditure incurred by the Project during the year under review. Details are given below.
 - (i) Payables amounting to Rs 424,647 as at the end of the year under review of the Sub Project Coordinating Unit in the North Western Province had not been brought to account.
 - (ii) The property plant and equipment used by the Local Governance Infrastructure Improvement Project valued at Rs. 87,111,839 which was transferred to this Project had not been brought to the account even up to 31 December 2013.

5.3 Non Compliance with Laws, Rules and Regulations etc.

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

- (a) The Boards of Survey on assets belong to the Project valued at Rs. 87,759,882 had not been carried out according to Financial Regulation No.756 to ascertain the physical existence of such assets.
- (b) According to the Financial Regulation No. 371(a) the advances are required to be settled as soon as the purpose of granting the advances completed. However, advances aggregating Rs. 660,837 obtained in 32 occasions by the officers of the Project attached to the Project Monitoring Unit had

been settled with delays ranging from 27 to 345 days. Further, it was observed that other 04 officers had obtained advances in 28 occasions without settling advances which they had previously taken.

6. Financial and Physical Performance

6.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provision for the year under review and the utilization of funds during the year under review and fund utilization as at 31 December 2013 are shown below.

Sources	Amount agreed for financing in the Loan Agreement		Budgetary provision for the year 2013	Funds Utilized during the year 2013	Funds Utilized as at 31 December 2013		Utilization of funds up to 31 December 2012 as a percentage of the provision
	US\$ million	Rs. million	Rs. million	Rs. million	US\$ million	Rs. million	
ADB	59.00	6,490	475	340	3.69	368	6.25
GOSL	9.77	1,075	75	67	0.70	71	7.16
Total	68.77	7,565	550	407	4.39	439	6.7

These figures are not agreed with the amount shown in the paragraph 4.1 of the Project due to inclusion of mobilization advance.

6.2 Physical Progress

According to the General Condition of the Project Preparatory Technical Assistance Report, the Project had agreed to allocate a sum of Rs. 50 million for 176 Pradeshiya Sabhas each to construct their administrative buildings. The progress as at 31 December 2013 on civil works carried out are given below.

Province	Amount allocated Rs. Million	No of Sub Projects allocated	Progress of the civil works as at 30 October 2014		
			Construction works to be completed	Construction works completed	Construction works not commenced
North Central	650	28	19	02	07
Central	900	28	15	01	12
Sabaragamuwa	800	25	12	-	13
North Western	650	21	14	01	06
Uva	800	27	13	02	12
Southern	1,100	29	16	01	12
Western	500	18	09	-	09
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	5,400	176	98	07	71
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Following observations are made.

- (a) According to the above information, the progress of the construction of administrative building for Pradeshiya Sabhas were remained only at 7 per cent as at 30 October 2014 even though the activities of the Project is scheduled to be closed on 31 December 2016.
- (b) It was observed that construction works of 71 out of 176 administrative buildings had not been commenced even lapse of 1 1/2 years of implementation of the Project. Thus indicated that slow progress of initiation of civil construction works.

6.3 Misappropriation of Assets

The truck valued at Rs. 3,450,574 handed over to the Welivitiya Divitura Pradeshiya Sabha in Southern Province on 11 September 2013 had been allowed to use to an outside party on rent basis.