

## **Conflict-Affected Region Emergency Project - Component "B" - 2013**

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The audit of financial statements of the Conflict-Affected Region Emergency Project - Component "B" 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 4.05 (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**

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According to the Loan Agreement of the Conflict-Affected Region Emergency Project, the Ministry of Economic Development is the Executing Agency and the Ministry of Power and Energy through Ceylon Electricity Board (CEB), the Ministry of Water Supply and Drainage through National Water Supply and Drainage Board (NWS&DB) and the Project Coordination and Quality Assurance Unit (PCQAU) 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. According to the Loan Agreement, the reallocated total cost of the Component "B" is US\$ 29.49 million and out of that US\$ 26.29 million or 89 per cent was agreed to be financed by the Asian Development Bank. According to the Grant Agreement, the Asian Development Bank is providing US\$ 1.50 million for civil works under National Water Supply and Drainage Board. The Project commenced its activities on 07 June 2010 and was scheduled to be completed by 30 September 2014.

### **1.3 Responsibility of the Management for the Financial Statements**

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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**

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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 the purchases made out of the Loan and Grant, etc.
- (c) Whether the withdrawals under the Loan and Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements.
- (d) Whether the funds, materials and equipment supplied under the Loan and Grant 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 withdrawals from and replenishments to the Imprest Fund Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances 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.
- (i) Whether financial covenants laid down in the Loan and Grant Agreements had been complied with.

### **3. Opinion**

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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 withdrawals from and replenishments to the Imprest Fund Accounts during the year ended 31 December 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balances 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 and Grant Agreements,
- (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 and Grant Agreements had been complied with.

### **4. Financial Statements**

#### **4.1 Financial Performance**

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According to the financial statements and information made available for audit, the expenditure for the year ended 31 December 2013 amounted to Rs.980,819,419 as compared with the expenditure of Rs.1,119,279,544 for the preceding year and the cumulative expenditure as at 31 December 2013 amounted to Rs.2,353,395,973. The following statement shows a summary of the expenditure for the year under review, for the preceding year and the cumulative expenditure as at 31 December 2013.

Description	Expenditure for the year ended 31 December		Cumulative
	-----		Expenditure as at
	2013	2012	31 December 2013
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	Rs.	Rs.	Rs.
Civil Works - Water Supply Board – Loan	323,106,845	233,427,326	633,185,625
Water Supply Board – Grant	24,103,981	178,185,515	202,289,496
CEB	551,574,464	663,592,082	1,354,337,998
Equipment - Water Supply Board – Loan	26,154,860	-	26,154,860
Water Supply Board – Grant	14,743,423	-	14,743,422
Consultancy – Water Supply Board	257,556	1,247,914	6,544,433
Incremental Operational Cost			
Water Supply Board	13,587,503	13,258,635	31,260,574
PCQAU	14,447,766	16,138,361	43,793,833
Equipment – PCQAU	4,181,498	2,985,669	9,046,691
Incremental Operational Cost - Commitment Charges	3,066,371	5,262,084	20,330,171
Interest	5,595,152	5,181,958	11,708,870
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Total	980,819,419	1,119,279,544	2,353,395,973
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#### 4.2 Imprest Fund Accounts

According to the financial statements and information made available, a summary of the operations of First Generation Imprest Fund Accounts (Loan and Grant) for the year ended 31 December 2013 are given below.

	Loan		Grant	
	US\$	Rs.	US\$	Rs.
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Balance as at 01 January 2013	495,699	63,033,528	21,133	2,687,290
Add: Foreign Exchange Gain	-	-	-	7,205
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	495,699	63,033,528	21,133	2,694,495
<u>Less:</u> Withdrawals - PCQAU	82,139	10,548,419	-	-
- Water Supply Board	407,567	51,674,588	20,963	2,672,294
Refund	-	-	170	22,201

Foreign Exchange Loss	-	26,846	-	-
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Balance as at 31 December 2013	5,993	783,675	-	-
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## 5. Audit Observations

### 5.1 Presentation of Financial Statement for Audit

Even though the financial statements for the year ended 31 December 2013 had been submitted for audit on 01 April 2013 those were rejected due to significant accounting deficiencies therein. However the financial statements amended by rectifying the accounting deficiencies aggregating Rs 189,748,579 had been resubmitted only on 30 June 2014.

### 5.2 Accounting Deficiencies

The following deficiencies were observed.

- (a) The gain on foreign currency exchange on ADB Loan as at 31 December 2013 had been overstated by Rs.1,920,224 due to the erroneous currency conversion rates applied in two occasions.
- (b) The ADB had agreed to administer the works carried out for water supply scheme at Point Pedro in Jaffna District under the grants of US\$1.5 million equivalent of Rs.196.13 million received by the International Federation of Red Cross and Red Crescent Societies (IFRC) under the Co- financing Agreement entered on 21 August 2011. Although the Grant was closed on 30 September 2013 only US \$ 1,403,054 equivalent of Rs.182,791,412 had been utilized. The following observations are made in this regard.
  - (i) The cost of work done as at 31 August 2013 amounting to US \$ 58,984 equivalent to Rs. 7,633,247 on mechanical, electrical and instrumentation works of the water supply scheme could not be reimbursed due to delay in forwarding the applications for withdrawals. Another three withdrawal applications for US\$ 114,252 equivalent to Rs. 14,973,069 relating to the said water supply scheme had been reimbursed from the ADB Loan instead of IFRC Grant.
  - (ii) A sum of Rs. 12,499,892 had been paid under the proceeds of the Grant for the purchase of equipment for the National Water Supply and Drainage Board. However, the Government of Sri Lanka contribution amounting to Rs.1,563,984 for the purchase of equipment had been treated under the proceeds of the Loan

instead of the Grant. Therefore, the non-current assets procured under the Loan had been overstated while that of the Grant had been understated by that amount.

- (iii) The expenditure amounting to Rs.30,243,783 incurred during the year under review out of the Grant proceeds shown in the financial statement did not agree with the expenditure amounting Rs.37,877,030 shown in the Annual Appropriation Account of the Ministry of Economic Development.
- (iv) Incremental operational cost of Rs.324,761 payable to the staff of the National Water Supply and Drainage Board at the end of the year under review had not been brought to account. As a result, value of incremental operational cost of the Component-B had been understated by that amount.

### 5.3 Non-compliance with Laws Rules and Regulations

Internal audit activities had not been carried out on the transactions of the Component-B in terms of Financial Regulation 133.

## 6. Financial and Physical Performance

### 6.1 Utilization of Funds

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

Source	Amount agreed to be financed under the Financing Agreement		Allocation made in the Annual Budget Estimates for 2013	Amount utilized during the year under review		Amount utilized as at 31 December 2013	
	US\$ Mn.	Rs. Mn.		US\$ Mn.	Rs. Mn.	US\$ Mn.	Rs. Mn.
ADB - Loan	26.29	3,437.42	922.0	0.49	906.18		2,064.44
- Grant	1.50	196.13	106.0	0.021	37.87	15.88	182.79
GOSL	3.38	442.59	45.5	-	36.77	1.4	106.16
<b>Total</b>	<b>31.17</b>	<b>4,076.14</b>	<b>1,073.5</b>	<b>0.511</b>	<b>980.82</b>	<b>17.28</b>	<b>2,353.39</b>

The following observations are made.

- (a) It was observed that the reimbursement applications valued at US\$ 20,140.61 equivalent to Rs.2,558,166 had been withheld during the year under review due to various reasons such as unauthorized transactions and duplication of claims, etc.,
- (b) The proceeds of the Loan amounting to Rs.2,136.36 million and the Grant amounting to Rs.217.03 million representing 55.4 per cent and 98.49 per cent respectively of the allocation amounting to Rs.3,855.79 million of the Loan and Rs.220.35 million of the Grant had been utilized as at 31 December 2013. Further, details on utilization of proceeds of the Loan and the Grant are given below.

Description	Estimated Expenditure (Reallocated)		Cumulative Expenditure as at 31 December 2013	Cumulative Expenditure as a percentage of Total Provision
	US\$ millions	Rs. millions		
Investment Costs				
Civil Works – CEB	15.47	2,022.70	1,354.34	66.96
NWS&DB	9.66	1,263.04	633.19	50.13
Equipment	2.34	305.95	26.15	8.55
Consultancy - Design and Supervision	0.08	10.46	6.54	62.52
Recurrent Cost				
Incremental - NWS&DB	0.45	58.83	31.26	53.13
Project Management - PCQAU	1.12	146.44	52.84	36.08
Interest and Commitment Charges	0.37	48.38	32.04	66.23
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Sub Total	29.49	3,855.80	2,136.36	55.40
Civil Works and Equipment - Grant	1.68	220.35	217.03	98.49
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		-		
Grand Total	31.17	4,076.14	2,353.39	57.73
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The following further observations are made in this connection.

- (i) The Component “B” of the Project was expected to be completed by 30 September 2014. However, after the elapse of over 80 per cent of the project period as at 31 December 2013, the Component B had utilized only 55.4 percent of the approved Loan.

- (ii) Even though a sum of Rs.3,285.74 million had been allocated for civil works of Ceylon Electricity Board and the National Water Supply and Drainage Board, only a sum of Rs.1,987.53 million or 60.48 per cent of the total provision had been utilized for intended purposes. However, in terms of Paragraph 12 of Table B of Overall Project Implementation Plan of the Project Administration Manual, almost all the power and water supply activities should be completed by the end of March 2013.