Community Livelihoods in Conflict Affected Areas Project (Re - awakening Project) - 2014

The audit of financial statements of the Community Livelihoods in Conflict Affected Areas Project (Re - awakening 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 Section 4.01 (b) (i) of Article IV of the Development Credit Agreement No. 3935 CE dated 23 July 2004 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. Subsequently, the Second Financing Agreement No. 4671 LK dated 11 January 2010 and the Third Financing Agreement No.4956 LK dated 29 November 2011 had been entered into between the Government of Sri Lanka and the International Development Association for providing additional financing for this Project.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreements of the Project, then Ministry of Economic Development, presently Ministry of Policy Planning and Economic Affairs is the Implementing Agency of the Project. The objectives of the Project are to help the conflict affected communities in the Northern and Eastern Provinces and the adjoining areas to restore livelihoods, enhance agricultural and other production and income and building capacity for sustainable, social and economic reintegration. As per the Financing Agreements, the estimated total cost of the Project is US$ 141.14 million equivalent to Rs 16,844.42 million and out of that US$ 124.70 million was agreed to be financed by the International Development Association. The contribution of the Government of Sri Lanka and the Project beneficiaries was US$ 13.72 million and US$ 2.72 million respectively. The Project commenced its activities on 23 July and 2004 and scheduled to be completed by 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 Sri Lanka Accounting Standards 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 physic]al terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loans, etc.

(d) Whether the withdrawals under the Loans had been made in accordance with the specifications laid down in the Financing Agreements,

(e) Whether the funds, materials and equipment supplied under the Loans 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 Sri Lanka Accounting Standards,

(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 Financing 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 at 31 December 2014 in accordance with Sri Lanka Accounting Standards.

(b) the funds provided had been utilized for the purpose 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 Financing 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 Financing Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

Value of Civil works and Grants amounting to Rs 5,460,207,471 and Rs.224,750,491 respectively shown under the Financing Agreement No.4956 in the financial statements had not agreed with the amounts of Rs.5,746,327,659 and Rs.254,932,535 shown in the subsidiary records maintained by the Project.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provisions for the year under review and utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed to be financed according to the Financing Agreements		Allocation made in the Budget Estimate	Funds Utilized			
				During the year under review		Up to 31 December 2014	
	US$ million	Rs. million	Rs. million	US$ million	Rs. million	US$ million	Rs. million
IDA Agreement No.							
3935	64.70	8,217.44	480.00	3.63	476.10	57.96	7,593.96
4671	12.00	1,400.28	24.00	0.18	23.56	10.32	1,352.29
4956	48.00	5,582.70	976.00	7.45	975.89	43.60	5,711.97
Beneficiaries	13.72	1,372.00	-	-	-	-	153.55
GOSL	2.72	272.00	131.00	-	131.19	-	1,606.22
Total	**141.14**	**16,844.42**	**1,611.00**	**11.26**	**1,606.74**	**111.88**	**16,417.79**

As a normal feature, the funds allocated by the Financing Agreements for the Components of the Project had been changed regularly by increasing of allocations for 09 Components ranging from 9 per cent to 75 per cent whilst decreasing of allocations ranging from 31 per cent to 83 per cent for other 03 Components. Thus, indicated that the physical activities planned to carry out under each Component had also been changed. Therefore, the doubt on achievements of financial and physical targets at the end of the period of the Project cannot be ruled out in audit.

3.2 Physical Progress

The following observations are made.

(a) According to the Project Progress Report prepared for the year 2014, details relating to the activities expected to be carried out during the year under review under the Component of Village Rehabilitation and Development and the activities completed up to 31 December 2014 are given below.

Activity	Number of activities to be completed		Number of activities completed up to 31 December 2014	
	First Financing Agreement	Second Financing Agreement	First Financing Agreement	Second Financing Agreement
Capacity Building	119,973	30,787	75,284	25,765
Infrastructure Development	2,411	1,023	2,363	1,070
Sub Loans on Livelihood Support	118,168	23,613	108,011	22,610

The following further observations are made.

(i) According to the above information, it was revealed that the physical progress under every activity as at 31 December 2014 was remained behind the targets. In this regard, the Project Director had explained that the targets had been made on tentative basis and actual beneficiaries had been selected for providing sub loans through the viability of the business proposals.

(ii) According to the Community Operation Manual of the Project, 10 per cent, 50 per cent and 40 per cent of total funds allocated for the village rehabilitation purposes should be utilized for capacity building, infrastructure development activities and sub loans for livelihood support activities respectively for the betterment of living condition of the beneficiaries. However, the actual utilization of funds under each category as at 31 December 2014 was 6.24 per cent, 30.41 per cent and 63.36 per cent respectively.

(b) It was observed that out of 114 activities targeted, only 69 activities had been implemented under the Component of Cluster Level Livelihood Development Programme launched by the Project and spent a sum of Rs.258.03 million thereon up to 31 December 2014. Out of the above mentioned 69 activities, 10 activities launched at a cost of Rs.9.57 million had been abandoned. The operations of another 28 activities had not been carried out satisfactorily by the beneficiaries even after incurring of Rs.32.62 million, due to improper coordination with the relevant community organizations. Further, it was observed that the expected benefits had not been received to the people involved in 19 activities of Family Economy Enhancement Packages under this Programme, due to lack of monitoring and proper supervision eventhough a sum of Rs.9.63 million spent by the Project thereon.

(c) The Project had launched a Black Gram Development Programme at Kumbukwewa village in the Puttalam District to increase the income of black gram farmers through increased awareness on cultivation and value addition to their products. Eventhough the Project had constructed a black gram processing centre consisting with storing facilities at a cost of Rs.5.4 million, the objectives of this Programme could not be achieved due to failure of carrying out other activities such as conducting training programme, registration of farmers and signing of forward sale agreement with buyers etc,. Further, the Dehulter Machine procured at a cost of Rs.65,000 on 24 February 2012 had remained idle from the date of procured.

(d) The Project had planned to establish an Eco - friendly Handmade Paper Production Programme in Puttalam District with the participation of 02 Village Development Organizations so as to provide employment opportunities for 60 youths. Out of the estimated cost of Rs.11.90 million, the Project had agreed to provide Rs.6.14 million for this purpose. According to the information received, the activities of the Programme commenced in January 2013 had been ceased in July 2013 due to several reasons such as delays in providing funds, problems in marketing of products and lack of market researches etc.

(e) Out of 144 village tanks expected to be rehabilitated up to 31 December 2014 under the Project, only 141 tanks had been rehabilitated as at that date.

(f) Further, 3,026 poly net houses expected to be constructed under the Component of Livelihood Restoration , only 1,229 poly net houses had been constructed up to 31 December 2014, due to design failures of poly net houses.

(g) The Project had implemented Micro Finance Scheme in 237 focal villages during period from 2005 to 2008 under the First Financing Agreement and a sum of Rs.183 million had been granted as sub loans for 8,935 beneficiaries. The following observations are made thereon.

(i) The details of outstanding sub loan balances as at 31 December 2014 could not be made available for audit as the Project had not updated the information with regard to outstanding sub loan balances from the month of September 2014. Further, the Project had not communicated the necessary information with the relevant Divisional Secretariats despite activities of the Project was scheduled to be closed on 31 December 2014 and the computer software developed in 2012 for the purpose of monitoring the sub loans granted under Micro Finance Scheme had also not been handed over to the relevant Divisional Secretariats. As a result, the recoverability of sub loan balances and viability of revolving of funds for sustainable operation of the Micro Finance Scheme was remained questionable in audit.

(ii) It was observed that cash balance amounting to Rs 12.2 million in hand at the offices of Deputy Project Directors and balance of Rs 219.1 million at Banks in 09 Districts is remained as at 30 September 2014.

(iii) It was observed that the Project had not taken any action, since 2008 to monitor and supervise the purposes of which the proceeds of sub loans used by the beneficiaries, allowing opportunities to misappropriate proceeds of sub loans.

(iv) Provision for bad debts had been made in the financial statements as at 31 December 2014 over 20 per cent for the sub loans granted to the beneficiaries in Vavuniya, Mannar, Jaffna, Kilinochchi and Mullaitivu districts.

3.3 Contract Administration

The following observations are made.

(a) According to the instruction issued by the Project, the Deputy Project Directors in district level are required to follow tender procedure to select a suitable supplier to acquire the poly net houses. It was observed that a private company had been selected to supply and install 428 poly net houses for all 10 districts without considering the capacity and past experience in this field. Further, the quantity of the materials such as GI pipes and other accessories used for several poly net houses were less than the required quantity and as a result, a sum of Rs. 3.28 million had been overpaid to the supplier for 300 poly net houses handed over to the respective farmers.

(b) The Project had awarded an another contract to procure 1,200 arch shaped poly net houses. The following further observations are made in this connection.

(i) It was observed that the specifications on procurement of arch shaped poly net houses had not been approved by the Technical Evaluation Committee and Procurement Committee of the Project. As a result, the Project had paid a sum Rs.22 million on variation of works and price escalation purposes.

(ii) According to the agreement entered into with the contractor, a sum of Rs.155,595 per arch shape poly net house had been allocated for supplying and installing poly net house in the Central Province. However, sums of Rs.318,180 and Rs.159,694 had been paid per poly net house supplied and installed in the Matale and Kandy Districts respectively. As a result, a sum of Rs.242,451 had been overpaid for 73 poly net houses installed in the Central Province.

(iii) It was observed that a sum of Rs.1,761,020 had been paid to other private company to repair arch shape poly net houses constructed in the Northern and Eastern Provinces during the defects liability period of the contract.

(c) According to the estimate prepared for construction of Unakatu Oya Anicut, a sum of Rs.604,539 had been allocated for supplying and fixing of a water control gate along with the gear box. However, a sum of Rs.1,465,200 had been paid additionally at the rate of Rs.244,200 per gear box for 6 gear boxes supplied and fixed by the contractor.

(d) The Project had spent a sum of Rs.623,876 on extra works for fixing 11 rubber water seal for water control gates supplied and fixed to Perappankadu Anicut, as the size of the gates pointed out in the drawings prepared by the Engineer is smaller than the required size.

(e) Even though a sum of Rs.667,500 had been paid for supplying and fixing of 150 cover slabs on construction of the drainage at a side of Al Hudha Road in Ninthavur, only 130 cover slabs had been supplied and fixed. Therefore, a sum of Rs.112,120 had been overpaid. Further, a sum of Rs.24,360 over paid on total payment of Rs.739, 935 made on placing concrete slab of 51.3 square metre , as the height of the wall of the drainage had been reduced at several locations and the size of the cover slabs was reduced by 1.68 square metre.

3.3 Matters in Contentious Nature

The following observations are made.

(a) The Project had procured 03 Combine Harvesters at a total cost of Rs.9.54 million on 03 June 2013 and out of those, 02 Harvesters had been handed over to the Village Development Organizations in the Ampara District. In order to avoid obtaining approval from the relevant authority, 03 quotations had been called separately to procure 03 Harvesters whilst the payments for Harvesters had been made by single voucher. Further, the supplier had agreed to provide repairs with free of charge for 5 years from the date of supply, however, the Village Development Organizations had repaired those Harvesters within the warranty period at their cost.

(b) It was observed that the Department of Forest had filed a case against the contractor engaged in rehabilitation of Jayawewa Tank in Mahaoya which located in the area of wildlife conservation on excavation of soil from the tank area without permission.

(c) The physical inspection carried out on 17 March 2014 on rehabilitation of Paburana- Sungawila Road at a cost of Rs.22,258,620 had revealed that Lankapura Pradesha Sabha had refused to take over the Road after the rehabilitation works carried out, as there were several pot holes on the surface of the road.