

North East Local Services Improvement Project (NELSIP) -2014

The audit of financial statements of the North East Local Services Improvement Project (NELSIP) for the year ended 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 Financing Agreement No.4728-LK dated 08 November 2009 and Grant Agreement No.TF 013787 dated 08 May 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association .

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement and Grant Agreement of the Project, then Ministry of Economic Development, presently the Ministry of Provincial Councils and Local Government is the Executing and Implementing Agency of the Project. The objective of the Project is to improve the delivery of local infrastructure services by Local Authorities in the Northern, Eastern, North Central, North Western and Uva Provinces of Sri Lanka in an accountable and responsive manner. As per the Financing Agreement and Grant Agreement, the estimated total cost of the Project is US\$ 106.30 million equivalent to Rs. 11,997.50 million and out of that Loan US\$ 50 million equivalent to Rs.5,500 million and Grant US\$ 20.30 million equivalent to Rs.2,537.5 million was agreed to be financed by International Development Association. The Project commenced its activities on 01 May 2010 and scheduled to be completed by 31 December 2015.

1.3 Activities of the Project

The activities of the Project scheduled to be carried out under 05 components are summarized below.

Component 1: Infrastructure Service Delivery

Provide grants to Local Authorities to enable them to carry out infrastructure development activities.

Component 2: Institutionalizing Accountabilities

Provide technical assistance to Local Authorities to enable them to carry out transparent and independent annual financial audit, social and technical audit and to deal with outstanding financial statements and audit issues. Carry out an education and communication campaign and development and implementation of systems and processes to enhance the operations of Local Authorities.

Component 3: Capacity Building

Enhance the capacity of the Local Authorities in the areas of planning, budgeting, financial management, procurement and Project management and to undertake audits

in an efficient and timely manner and strengthening the capabilities of the Project Implementation Units.

Component 4: Assessment and Evaluation

Establish a comprehensive system to monitor the activities of the Local Authorities and carry out evaluations and analysis about the operations of the Local Authorities.

Component 5: Project Management

Strengthen the capacity of the Project Management Units.

1.4 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.

1.5 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 risk of material misstatements of financial statements, whether due to fraud or error. In making those risk assessment, 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. The 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 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 test 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 Donor 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 Credit and Grant, etc.
- (d) Whether the withdrawals under the Credit and Grant had been made in accordance with the specifications laid down in the Financing Agreement and Grant Agreement.
- (e) Whether 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 Agreement and Grant Agreement.
- (f) Whether the funds, materials and equipments supplied under the Credit and Grant had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the opening and closing balances, withdrawals from and replenishments to the Special Dollar Account during the year ended 31 December 2014 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (i) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (j) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (k) Whether the financial covenants laid down in the Financing Agreement and Grant Agreement had been complied with.

1.6 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 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, withdrawals from and replenishments to the Special Dollar Account during the year ended 31 December 2014 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) 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 Financing Agreement and Grant Agreement,
- (e) the 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 Financing Agreement and Grant Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

According to the information received, a sum of Rs. 2,585 million had only been utilized as at 31 December 2014 by 79 Local Authorities, out of the proceeds amounting to Rs.3,300 million released for infrastructure development activities of such Local Authorities. However, the entire amount released had been shown in the financial statements as the costs incurred.

2.2.2 Non - Compliance with Laws, Rules and Regulations

The following instances of non – compliance were observed in audit.

- (a) The Budget Estimate for the year under review as required to be prepared according to the Section 1. 3.4 of Schedule 2 of the Financing Agreement had not been prepared by the Project.
- (b) The detailed statements on Value Added Taxes as required by the Public Finance Circular No.364 (3) had not been furnished to the Commissioner General of Inland Revenue relating to the civil works and goods procured at Rs.461.99 million during the year under review.
- (c) Seven payments vouchers aggregating Rs.119.89 million had not been certified in term of Financial Regulation No. 138 by the Project Office of the Northern Province during the year under review.

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 to be financed according to the Financing and Grant Agreement		Funds utilized			
	US\$ million	Rs. million	during the year 2014		up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
Loan	50.00	5,500.00	12.34	1,608.97	49.91	6,185.00
Grant	20.30	2,537.50	8.05	1,167.69	8.08	1,167.69
GOSL	34.00	3,740.00	0.61	67.66	14.06	1,546.57
Community Contribution	2.00	220.00	2.71	298.82	4.64	510.35
	<u>106.30</u>	<u>11,997.50</u>	<u>23.71</u>	<u>3,143.14</u>	<u>76.69</u>	<u>9,409.61</u>

The following observations are made.

- (a) Out of the Grant of US\$ 20.30 million allocated for the activities of the Project, only US\$ 8.08 million had been utilized as at 31 December 2014. The possibility of utilization of balance fund of US\$ 12.22 million within the rest of the period of 01 year is remained doubtful due to lack of a comprehensive plan.

- (b) According to the information received , out of the allocations of Rs.40.5 million and Rs.43.5 million made for assessment and evaluation purposes and institutionalizing of accountability framework of the Local Authorities respectively only Rs.14.10 million and Rs. 22.47 million had been utilized as at 31 December 2014.

3.2 Physical Progress

According to the information collected, the allocations aggregating US\$ 90 million equivalent to Rs.9,950 million had been made for infrastructure developments in the areas of 79 Local Authorities and the physical progress of the works carried out thereon is given below.

Development Activity	Expected Progress As at 31 December 2014	Achievement As at 31 December 2014	Percentage (%) of Achievement
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Access Road Development			
- Tarring	865 kilometres	379 kilometres	43.0
- Concreting	135 kilometres	259 kilometres	191.0
Constructing of Parks/ Markets and development of small towns	405 Nos	171 Nos	42.0
Sewerage/ Drainage	245 kilometres	41 kilometres	16.0
Waste disposal system	66 Nos	01 Nos	1.5
Rural water supply system	439 Nos	22 Nos	5.0
Rural Electrification	187 kilometres	23 kilometres	12.0

When Compare to time available for completion of balance work and works to be completed it is doubt whether Project is in position to achieve the Project objectives within project period.

3.3 Contract Administration

The following observations were made.

- (a) The audit tests checks made on payments of 04 road rehabilitation works carried out by Valvettithurai Urban Council, Vavuniya South Sinhala Pradeshiya Sabha, Karainagar Pradeshiya Sabha in the Northern Province had revealed that the rates quoted in the bid documents had been altered subsequently and a sum of Rs. 4.42 million had been paid to the contractor thereon.

- (b) It was observed that the Project Engineer had functioned as the Chairman of the Technical Evaluation Committees for selecting bidders for the contracts for rehabilitation works carried out by Vavuniya South Sinhala Pradeshiya Sabha and offered such contracts to his own company.
- (c) Eventhough a sum of Rs.1.14 million had been paid for extra works on contract for the construction of market and shopping complex at Manandy without obtaining the approvals for variation orders from the relevant authorities. Further, it was observed that the construction works of Manandy market had been offered to sub- contractors in contrary to provision in Loan Agreement.
- (d) The contract for the construction of road from Illakaiturai Main Road to Punniyady Jetty Road awarded at a cost of Rs.11.5 million and expected to be completed by 10 April 2012 had been abandoned due to failure of the contractor. However, Verugal Pradesiya Sabha in the Eastern Province had not taken timely action to recover the advance amounting to Rs. 2.3 million by encashing advance bond. Further, performance bond also not encashed due to abandon of the contract.
- (e) In addition, the contract for reconstruction of Punniyady Jetty Road at a cost of Rs.17.6 million had been awarded on 03 April 2012 to complete works within 3 months had also been abandoned due to failure to commence the work. However, mobilization advance amounting to Rs.3.53 million and performance bond had not been encashed even up to expiration of these bonds and no action had been taken against the officer who responsible.

3.4 Idle / Under Utilized Assets

It was observed that 27 shops at the shopping complex of Muttur Pradeshiya Sabha and Vellaimanal Market in Trincomalee had remained idle for over 03 years without taking action to use for intended purposes.

3.5 Unsettled Audit Issues Highlighted in the Previous Audit Reports

According the matters pointed out in my report for the year ended 31 December 2013, Value Added Taxes amounting to Rs.16.2 million had been paid to the contractors engaged in civil works carried out by a Urban Council and 09 Pradeshiya Sabhas in 19 instances without verifying the validity of the registrations for Value Added Tax payments. In this connection, meaningful actions had not been made by Project Management Unit to recover the payment from the relevant parties concerned.