

Climate Resilience Improvement Project - 2015

The audit of financial statements of the Climate Resilience Improvement Project for the year ended 31 December 2015 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 4:09(b) of the Financing Agreement No:5417-LK dated 10 July 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 of the Climate Resilience Improvement Project, the Ministry of Irrigation and Water Resources Management is the Executing Agency of the Project and the Department of Irrigations, Mahaweli Authority of Sri Lanka, Road Development Authority and National Building Research Organization are the Implementing Agencies of the Project. The objectives of the Project are to reduce the vulnerability of exposed people and assets to climate risk and improve the Recipient's capacity to respond effectively to disasters. According to the Financing Agreement, the estimated total cost of the Project amounted to US\$ 111.8 million equivalent to Rs.14,617 million and out of that US\$ 110 million equivalent to Rs.14,382 million was agreed to be financed by the International Development Association. The Project commenced its activities on 05 August 2014 and scheduled to be completed by 30 May 2019.

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 physical terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loan, etc,
- (d) Whether the opening and closing balances and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the application for reimbursement in accordance with requirements specified in the Financing Agreement.
- (f) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Financing Agreement.
- (g) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (h) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (i) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (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 had been complied with.

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, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purpose for which they were provided,
- (c) the opening and closing balances and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 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 application for reimbursement in accordance with requirements specified in the Financing 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 had been complied with.

3. Financial Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and utilization of funds during the year under review and up to 31 December 2015 are shown below.

Source	Amount agreed for financing in the Financing Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds Utilized</u>			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
IDA	110.0	14,382	1,825	9.95	1,300	10.26	1,342
GOSL	1.8	235	25	0.13	17	0.23	31
Total	<u>111.8</u>	<u>14,617</u>	<u>1,850</u>	<u>10.08</u>	<u>1,317</u>	<u>10.49</u>	<u>1,373</u>

It was observed that the adequate allocation had not been made in the Budget Estimate for the year under review as enable to utilize the proceeds of the Loan allocated under the Financing Agreement and smooth operations of the activities of the Project throughout the period of the Project. Therefore, the allocation of Rs.1,825 million had only been made for the year under review eventhough allocations of Rs 2,800 million in average required to be provided annually for optimum utilization of the proceeds of the Loan at the end of the period of the Project. Out of the allocation made for the year under review, a sum of Rs 1,300 million had only been utilized as at 31 December 2015. It indicated that the possibility of accumulation of the unutilized proceeds of Loan at the latter part of the period of the Project allowing opportunities for wastages and misappropriations etc,.

3.2 Physical Progress

The activities of the Project mainly focus to establish more climate resilience economy and consisted with 04 main components of development of basin investment plans, increasing of climate resilience of infrastructure, implementation support of the Project and contingent emergency response. It was observed that slow progress on activities implemented under the each components of the Project as at 31 December 2015 even after lapse of 17 months from the date of commencement of the activities of the Project due to the following reasons.

- (a) The office of the Project Monitoring Unit had not been established in a separate location even in December 2015 as enable to establish an administrative and monitoring mechanism for smooth operations of the activities of the Project. Further, the Project Monitoring Unit was operated with shortage of suitable experts for the key posts of Sociologist, Environmentalist and Procurement Specialist and other several posts of supporting staff.

- (b) Action had not been taken by the Ministry of Irrigation and Water Resources Management to award the contracts even as at 31 December 2015 for Consultants for the preparation and development of investment plans for 10 basins which is the main activity of the Project. Further, satisfactory progress had not been shown on air surveying purposes even the requests had been made to the relevant authorities in September 2015.
- (c) The National Building Research Organization runs with shortage of consultancy staff. As a result, the progress on awarding of contracts for the slope stabilization works of 13 schools, out of 18 schools in Kandy district which are vulnerable to landslide risks were remained slow. Eventhough the National Building Research Organization had taken action to recruit Consultants on contract basis it would not be able to accelerate the consultancy services to the Project in short time due to lack of experiences of the Consultants as well as contractors on slope stabilization works.
- (d) The Road Development Authority had involved to rehabilitate bridges under 09 contract packages and stabilization of slopes in road sides under 17 packages to prevent landslides and ensure transport continuity. The contracts for bridge rehabilitation works had been awarded during the year under review under 03 packages and out of that, the progress of rehabilitation works of the bridge of Nedimala- Boralessgamuwa Road was remained behind the targets due to delays in shifting of utility services such as telephones and water lines. Further, 03 contract packages awarded for stabilization of slopes in road sides of Kandy- Mahiyangana Road had shown a slow progress due to lack of experts knowledge for the Road Development Authority as well as the National Building Research Organization on stabilization of slopes at the road sites.

3.3 Contract Administration

The Department of Irrigations had implemented several floods and drought mitigation Projects in the Eastern, North Central, North Western, Southern and Uva Provinces. The site visits made by the auditors on the mitigation activities implemented by the Provincial Engineering Office of the Irrigation Department at Tissamaharamaya in the Southern Province had observed that the water leakages of the sidewall of the distribution canals constructed by the Project under the mitigation project of Yodha Wewa and Tissa Wewa. It provided evidence that the supervisory activities of the works were not adequately implemented by the Department of Irrigations to ensure the quality and sustainability of the works done. Further, it was observed that 35 mitigation projects were expected to be implemented by the Provincial Engineering Office of the Department of Irrigations at Weeraketiya and out of that, designs of works and cost estimation had been prepared only for 25 mitigation projects and the construction works under 09 mitigation projects had been completed during the year under review.

3.4 Issues on Financial Controls

The internal audit activities of the Project are implemented by an Internal Audit Committee consisted with the a Director and an Accountant of the Department of Irrigations, a Director of Mahaweli Authority of Sri Lanka, and 03 other senior audit officers of Road Development Authority, National Building Research Organization and the Ministry of Irrigation and Water Resources Management appointed by the Project Director. According to the observations contained in the internal audit reports, it was revealed that detailed investigations had not been carried out as enable to make material findings on activities of the Project. Further, some of the above mentioned officers involved in management decision making process on implementation of the activities of the Project and therefore, independent reviews on the operations of the Project would not be carried out. Therefore, the internal audit activities had not been carried out adequately, as required by the Financial Regulation 134 (3).