

## **Improvement of Basic Social Services Targeting Emerging Regions Project – 2015**

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The audit of financial statements of the Improvement of Basic Social Services Targeting Emerging Regions 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 (6) of Article III of the Loan Agreement No. SLP-105 dated 28 March 2012 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Japan International Cooperation Agency (JICA).

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

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According to the Loan Agreement of the Improvement of Basic Social Services Targeting Emerging Regions Project, then Department of National Planning of the Ministry of Finance, presently Department of Project Management and Monitoring of the Ministry of National Policies and Economic Affairs is the Executing Agency and the Ministry of Health, Nutrition and Indigenous Medicine and the Eastern, North Western, Central and Sabaragamuwa Provincial Councils are the Implementing Agencies of the Project. The objectives of the Project are to improve the health, medical system and strengthen the production capacity of essential drugs through improving facilities and equipment in secondary level hospitals and the State Pharmaceutical Manufacturing Corporation, thereby contributing to the enhancement of non – communicable diseases management. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 4,760 million equivalent to Rs.6,332 million and out of that Japan Yen 3,935 million equivalent to Rs.5,155 million was agreed to be provided by the Japan International Cooperation Agency. The Project commenced its activities on 23 July 2012 and scheduled to be completed by 23 July 2019.

### **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 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**

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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 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 are 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 which 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 are 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 identification of the purchases made out of the Loan, etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipment supplied under the Loan 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 Generally Accepted Accounting Principles.
- (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.

## **1.5 Basis for Qualified Audit Opinion**

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My opinion is qualified based on the matters described in paragraph 2.2 of this report.

## **2. Financial Statements**

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### **2.1 Opinion**

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So far as appears from my examination and 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 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 Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (d) the financial covenants laid down in the Loan Agreement had been complied with.

## **2.2 Comments on Financial Statements**

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### **2.2.1 Accounting Deficiency**

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Direct payments of Rs.776,071 and Rs. 232.37 million made during the year 2014 and 2015 respectively had not been brought to account. Therefore, the balances of Loan and Civil works shown in the financial statements as at 31 December 2015 were understated by that amount.

## **3. Financial and Physical Performance**

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### **3.1 Utilization of Funds**

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

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	-----			during the year under review		as at 31 December 2015	
-----	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	3,935	5,155	1,530	628	692	1,663	2,018
GOSL	825	1,177	310	108	132	253	370
<b>Total</b>	<b><u>4,760</u></b>	<b><u>6,332</u></b>	<b><u>1,840</u></b>	<b><u>736</u></b>	<b><u>824</u></b>	<b><u>1,916</u></b>	<b><u>2,388</u></b>

According to the above information, allocations of Rs. 1,530 million had been made for the year under review in the Budget Estimate and out of that, only Rs. 692 million had been utilized as at 31 December 2015. Thus, it indicated that the Project had not taken action to utilize the allocation made by the Budget Estimate to carry out the activities of the Project during the year under review.

### 3.2 Physical Progress

According to the Action Plan of the Project, it was planned to improve the capacities of Base Hospitals at Warakapola, Galgamuwa, Teldeniya and Kalawanchikudy and improve the production capacities of the State Pharmaceutical Manufacturing Corporation. The observations on the physical progress of the activities of the Project are given below.

- (a) According to the contract agreement, the construction works of 06 storied clinical building and 02 storied residential building for Warakapola Base Hospital at a cost of Rs. 514 million were expected to be completed by 20 June 2015. However, the physical progress of the construction works of the buildings was remained at 86 per cent as at 31 December 2015. According to the explanation made by the Project Director, the construction works could not be completed within the specific period due to bad weather condition, unexpected ground condition and failures of the contractor. Further, the period for the consultancy services which agreed to be provided upto December 2014 had also been extended up to February 2016 due to delays in construction works and additional cost of Rs. 6.13 million had been spent thereon.
- (b) The building construction works for theaters and wards of Galgamuwa Base Hospital under the Package-I had been completed and handed over on 30 May 2015. However, respective theaters and wards had not been opened for the use of general public even as at 29 February 2016. Further, the construction of buildings for Outdoor Patient Department and Administration Unit and installation of air conditioning system under the Package-II awarded on 05 October 2014 at a cost of Rs. 239 million had not been completed even though extensions of time had been granted in 02 occasions.

- (c) The contract awarded at a cost of Rs. 374 million for construction of 05 storied new building for Teldeniya Base Hospital had not been completed as at 31 December 2015 even though extensions of time had been granted in 02 occasions since 06 August 2015.
- (c) The construction of extension building for the Outdoor Patient Department, other renovations works of the buildings of the Kalawanchikudy Based Hospital had been carried out under 03 packages and substantially completed as at 30 June 2015.
- (d) According to the action plan of the Project, a sum of Rs. 768.36 million had been allocated for the acquisition of bio medical instruments for 04 hospitals and required to be completed by 31 December 2015. However, the provincial health authorities had entered into with agreements only on 10 February 2016 to procure bio medical instruments for Teldeniya and Kalawanchikudy Base Hospitals. Action had not been taken to enter into agreements by the provincial health authorities for the procurement of bio medical instruments for Warakapola and Galgamuwa Base Hospitals even as at 31 December 2015.
- (f) According to the Action Plan of the Project, 50 per cent of the development works were scheduled to be completed as at 31 December 2015 on strengthening of the production capacity of State Pharmaceuticals Manufacturing Corporation at an estimated cost of Rs.1,493 million. However, the progress reports indicated that the respective works had remained at the initial stages.

### **3.3 Contract Administration**

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It was observed that the original Bill of Quantities of the construction works at the Warakapola Base Hospital had been prepared based on the allocations made under the Loan Agreement and several essential requisites for the construction of the buildings were ignored. Therefore, the works such as installation of fire protection system, medical gas system, tiling works of 02 upper floors, ceiling works of residential building and railing works of the stair cases etc were not included in the original Bill of Quantities. Separate contracts had been awarded to the other contractors at a cost of Rs.55.44 million to complete such works by utilizing the allocation made by the Government of Sri Lanka. In addition, the rehabilitation works of access roads to the Hospital had been completed at a cost of Rs. 30.15 million through other contractors. Further, provisional allocations aggregating Rs. 85.54 million made in the original Bill of Quantities for air conditioning system, bed lift installation, sewerage treatment plant had been carried out by other contractors and additional cost of Rs. 23.44 million had been spent thereon.