

Strategic Cities Development Project - 2015

The audit of financial statements of the Strategic Cities Development 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 II (B) (3) of the Financing Agreement No.5428-LK dated 12 September 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 Project, then Ministry of Urban Development Water Supply and Drainage presently, the Ministry of Megapolis and Western Development is the Executing Agency and the Implementing Agency of the Project. The objective of the Project is to improve selected urban services and public urban spaces in the Participatory City Regions of Sri Lanka. Therefore, Kandy City and Galle City had been selected as the Participatory City Regions to be developed under the Project. As per the Financing Agreement, the estimated total cost of the Project was SDR 95 million (US\$ 192.08 million) equivalent to Rs. 25,162.48 million and out of that US\$ 147 million equivalent to Rs.19,257 million was agreed to be provided by the International Development Association. The Project commenced its activities on 05 May 2014 and scheduled to be completed by 31 December 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 Credit 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 Credit had been made in accordance with the specifications laid down in the Financing Agreement,
- (g) Whether the funds, materials and equipment supplied under the Credit 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 Standard,

- (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.

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 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 provide,
- (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 statements laid down in the Financing Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) A sum of Rs. 939,744 payable to the Urban Development Authority as at 31 December 2015 had been shown under Project Fund Account instead of being shown under current liabilities.
- (b) The provision for depreciation had not been made on plant, property and equipment procured at a cost of Rs. 16.39 million in the previous year. As a result, provision for depreciation on plant, property and equipment as at 31 December 2015 had been understated by Rs. 1.77 million.

2.2.2 Non-compliance with Laws, Rules and Regulations

The following observations are made.

- (a) According to the instructions issued by the Circular No. ERD/2007/2 of 07 August 2007 of the External Resources Department of the Ministry of Finance and Planning, the financial statements of the Project is required to be presented for audit on or before 31 March of the following year. However, the financial statements for the year under review had been furnished for audit only on 02 May 2016.
- (b) A Procurement Administration Manual to be prepared by the Project, as required by the Paragraph 24 of the Project Appraisal Document had not been prepared even as at 31 December 2015.

2.2.3 Issues on Replenishment of Donor Funds

According to the information received, a balance of US\$ 6.65 million equivalent to Rs. 871.83 million had remained as at 01 January 2015 in the Special Dollar Account maintained by the Project at the Central Bank of Sri Lanka. In addition, the imprests of US\$ 03 million equivalent to Rs. 503.25 million had been made on 10 June 2015 and out of that only US\$ 3.48 equivalent to Rs. 475.92 million had been withdrawn during the year under review. Therefore, the balance of US\$ 6.16 million equivalent to Rs. 888.68 million had remained in the Special Dollar Account excessively as at 31 December 2015 due to poor forecasting of financial needs for the activities of the Project.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics 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 according to the Financing Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		during the year under review	US\$ million	Rs. million	up to 31 December 2015
IDA	147.00	19,257.00	3,450.00	2.78	367.99	2.93	387.29
GOSL	45.08	5,905.48	960.00	0.69	91.02	1.01	132.94
Total	<u>192.08</u>	<u>25,162.48</u>	<u>4,410.00</u>	<u>3.47</u>	<u>459.01</u>	<u>3.94</u>	<u>520.23</u>

The following observations are made.

- Although there must be a comprehensive detailed action plan highlighting financial and physical targets in monthly, quarterly, biannually etc. covering entire Project period with fixing responsibilities to achieve the targets within specific Project period, such a plan had not been prepared and implemented.
- Further, the detailed budget for the year under review based on the Work Schedule of the Project, as required by the Paragraph 11 of the Project Appraisal Document had not been prepared. Therefore, a sum of Rs 459.01 million had only been utilized during the year under review, out of the allocation amounting to Rs 4,410 million had been made in the Budget Estimate of the Government for the year under review.
- According to the above information, out of total funds of US\$ 147 million equivalent to Rs 19,257 million allocated by the Lending Agency, only US\$ 2.93 million equivalent to Rs 387.29 million representing 02 per cent of the total allocation had been utilized as at 31 December 2015 after lapse of 02 years from the commencement of the activities of the Project.

3.2 Physical Progress

The Project had taken action to implement several programmes during the year under review to improve selected urban services and public urban spaces in Kandy and Galle Cities. The following observations are made thereon.

- (a) It was observed that 06 meetings of Project Steering Committee and 04 meetings of Project Consultative Committee had been held during the year under review. However, the representatives of respective Municipal Councils, Road Development Authority, Urban Development Authority, Department of Irrigation and National Water Supply and Drainage Board had not been appointed for the above mentioned Committees, on permanent basis. Therefore, the fruitful decisions could not be taken at the meetings of the Committees to ensure smooth operations of the Project by delegating responsibilities among the above mentioned Agencies.
- (b) Renovation works of main canals and drainage system in Galle City scheduled to be completed within two year period had not been commenced even as at 30 April 2016. Further, rehabilitation of 03 roads, reconstruction works of Port Rampart Walkways and improvement works of other infrastructure facilities of the Galle Municipal Council area scheduled to be commenced during the year under review had not been commenced even as at 30 April 2016. The reconstruction works of 03 bridges at Samagiwaththe, Kanampitiya and Beligaha, out of 05 bridges to be reconstructed in Galle City had shown slow progress of 07 per cent in average, eventhough it was expected to complete 50 per cent of works at end of the year under review.
- (c) The rehabilitation works of Arthur's Seat Viewing Deck and design and construction, supervision, augmentation and rehabilitation works of Water Supply System in Kandy City area had reported slow progress of 40 per cent and 85 per cent respectively as at 31 December 2015 eventhough it was expected to complete the activities as at that date.

3.3 Contract Administration

The following observations are made.

- (a) The process of bid opening and entering into agreement on 04 construction and consultancy contracts on development works of Kandy City at a cost of Rs 373.80 million had been implemented with delays ranging from 03 to 06 months. In addition, 03 construction and consultancy contracts on development works of Galle City awarded at a cost of Rs.163.82 million had been processed with delays in 03 months. Further, the activities carried out

under surveying of 03 lands for acquisition purposes and landscaping works at Louise Peris Mawatha in Kandy had been completed with delays in 06 months and 08 months respectively. The works related to establish the National Grid for bridges in Galle City had been completed with delays in 13 months from the date scheduled to complete the works .

- (b) The field inspections made by the auditors on construction works of 03 ground reservoirs in Kandy City had revealed that 67 tons of steel bars valued at Rs.13.40 million had been procured on 13 March 2015, more than the quantity required for the construction purposes. As a result, mobilization advances amounting to Rs 2.68 million had been paid to the contractor on costs overstated unduly. It was further observed that a sum of Rs. 1.2 million had been overpaid on 09 items of Bill of Quantity under the Claim No.01 of the contractor made on the above mentioned construction works.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) A sum of Rs. 209,000 had been spent, out of the contribution received from the Government of Sri Lanka for air travelling from Colombo to Jaffna in two instances during the year under review. However, the necessity of air travel was not explained for audit.
- (b) A sum of Rs. 700,920 had been paid as remunerations to 05 officers who worked in the Project Monitoring Unit on part time basis, out of the contribution received from the Government of Sri Lanka. However, the duty lists or Terms of References to determine the nature of the assignments made by the Project were not made available for audit.

3.5 Payment of Compensation on Lands Acquired

The Project had planned to acquire 1,632 plots of land at an estimated cost of Rs. 662 million and out of that 820 plots of land had been acquired up to end of the year under review. Further, a sum of Rs. 188 million had been paid as additional compensations, out of the total amount of Rs 235 million spent on lands acquisition purposes. The details such as extend of lands acquired and the reasons for the payment of additional compensations of Rs. 8.07 million for 14 plots of land in 03 Divisional Secretariats under the recommendations of the Land Acquisition Resettlement Committee had not been furnished to audit.

3.6 Human Resources Management

The Scheme of Recruitment for Project staff had been approved by the Department of Management Services on 29 January 2014 and it was observed that 8 Posts out of 16 Posts of senior management positions had remained vacant up to May 2016.

3.7 Issues on Financial and Physical Control

The following observations are made.

- (a) A Register of Fixed Assets had not been maintained in proper manner to record the property, plant and equipment procured by the Project.
- (b) As required by the Financial Regulation No. 134(3) and the Circular No. 05 of 20 July 2010 of the Department of Management Services, the transactions of the Project had not been subjected to audit of the Internal Audit Section of the Line Ministry.