

Local Government Enhancement Sector Project (Pura Neguma) - 2016

The audit of financial statements of the Local Government Enhancement Sector Project (Pura Neguma) for the year ended 31 December 2016 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 4.02 of Article IV of the Loan Agreement No. 2790-SRI(SF) dated 21 October 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Local Government and Provincial Councils, presently the Ministry of Provincial Councils and Local Government is the Executing Agency and the Provincial Councils of 07 Provinces are the Implementing Agencies of the Project. The main objective of the Project is to achieve improved local government infrastructure and effective delivery of services through accountable, and financially and technically strengthened local authorities. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 68.8 million equivalent to Rs. 8,940 million and out of that US\$ 59 million equivalent to Rs. 7,670 million was initially agreed to be financed by the Asian Development Bank. However, the agreed amount had been determined as US\$ 52.04 million equivalent Rs.7,892 million, due to appreciation of US\$ against Special Drawing Rights. The Project commenced its activities on 01 July 2012 and scheduled to be completed by 30 June 2015. Subsequently, the period of the Project had been extended up to 30 June 2017.

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 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

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 identification of the purchases made out of the Loan etc.
- (d) Whether the opening and closing balances, 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (f) Whether the funds, materials and equipment supplied under the Loan 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 financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (i) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) Whether the financial covenants laid down in the Loan 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 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 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka 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 Loan 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 Loan Agreement had been complied with.

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 2016 are shown below.

Source	Amount agreed for financing as per the Loan Agreement		Allocation made in the Budget Estimate for the year 2016		<u>Funds utilized</u>			
	US\$ million	Rs. million	US\$ million	Rs. million	during the year under review		as at 31 December 2016	
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	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	52.04	7,892.00	19.73	2,899.71	17.50	2,571.95	45.02	6,149.07
GOSL	9.77	1,270.10	2.89	424.33	2.86	420.46	8.11	1,102.92
Total	<u>61.81</u>	<u>9,162.10</u>	<u>22.62</u>	<u>3,324.04</u>	<u>20.36</u>	<u>2,992.41</u>	<u>53.13</u>	<u>7,251.99</u>

3.2 **Physical Progress**

According to the General Condition of the Project Preparatory Technical Assistance Report, the Project had agreed to allocate a sum of Rs. 50 million for selected Local Authorities each to construct their administrative buildings and improvements of infrastructural and other community facilities. The physical progress on civil works implemented by the Local Authorities as at 31 December 2016 is given below.

Nature of the works -----	No of Local Authorities involved -----	Development works	
		expected to be completed during the period of the Project -----	completed as at 31 December 2016 -----
	Nos	Nos	Nos
Construction of Administrative Buildings	39	40	37
Development of Infrastructural Facilities	21	21	19
Improvement of Community Facilities	80	89	87
Water Supply Projects	18	25	16
Others	3	3	3

It was observed that the slow progress ranging from 50 per cent to 85 per cent had been reported on water supply projects implemented by Wanathavilluwa, Maho and Galnewa Pradeshiya Sabhas in the North Western Province, Udapalatha Pradeshiya Sabha in the Central Province and Hadungamuwa, Mahiyanganaya and Meegahakiula Pradeshiya Sabhas in the Uva Province, due to delays in awarding of the contracts. Therefore, the possibility of completion of such works even at the end of the period of the Project cannot be determined in audit.

3.3 Contract Administration

The following observations are made.

- (a) As a common feature, the quality failures of newly constructed buildings and other structures were revealed at the site visits made by the auditors. As a result, a part of the retaining wall constructed at a cost of Rs. 41.44 million at the premises of weekly fair of Neluwa Pradeshiya Sabha in the Southern Province had been collapsed. Further, cracks were appeared in the boundary walls constructed at the total cost of Rs.80.39 million at the premises of Karadeniya, Thissamaharama and Katuwana Pradeshiya Sabhas in the Southern Province and multi- purpose buildings constructed by Tennekumbura of Kandy Kadawath Sathara and Gangawata Korale Pradeshiya Sabhas in the Central Province. It evidenced that the civil construction works implemented by several Local Authorities were not supervised in proper manner, as enable to adhere with the quality standard.
- (b) The fish market building consisted with 3,015 square feet which constructed at a cost of Rs.5.83 million at the weekly fair of Thissamaharama Pradeshiya Sabha had been allowed to use of a businessman for commercial purposes without entering into

an agreement. Therefore, the respective Pradeshiya Sabha could not be able to generate expected returns on investments made by the Project.

- (c) The plastic crusher machine and polythene compactor installed at the Waste Management Centre of Agalawattha Pradeshiya Sabha at a cost of Rs. 32.09 million was not remained in usable condition even as at 30 June 2017, due to lack of electricity connections. Further, the Compost Production Centre constructed at a cost of Rs. 5.31 million at Mahailuppallama and Thirappane in the North Central Province had remained unused even as at 30 June 2017 due to lack of water supply.
- (d) The estimated cost of Rs.45.94 million of the contract for the construction of multi-purpose building for Harispaththuwa Pradeshiya Sabha in the Central Province which consisted with facilities for offices, health and maternity care, auditorium and library had been increased up to Rs.60.18 million, due to the designing errors and initiating of construction works without soil investigations. According to the explanations made by the Project Director, the additional cost had to be incurred on strengthening of the foundation of the building.
- (e) It was observed that the facilities such as access roads and electricity supply etc had not been provided for the newly constructed bus stand at Meegahakiula in the Uva Province at a cost of Rs. 13.76 million. Therefore, an additional cost of Rs. 9.15 million had been spent by the Pradeshiya Sabha to take legal action to acquire a land to provide access facilities. As a result, the bus stand was not opened for the use of general public even as at 31 March 2017.
- (f) It was observed that the water supply scheme at Palindanuwara Pradeshiya Sabha in the Western Province was remained idle due to deteriorated quality of water. Further, the Pradeshiya Sabha had not taken action to evacuate the people reside closer to water stream and protect the water source against pollution. A sum of Rs.28.62 million had been spent during the year under review by the Project to provide drinking water from outside sources for 360 families. Further, the quality of water of Diklanda Water Supply Scheme of Kalutara District in the Western Province which expanded its capacity at a cost of Rs. 28.62 million was also not suitable for drinking purposes, due to bacterial effects on mixing waste water.
- (g) The Water Supply Scheme at Remuna in Kalutara District was also not functioned effectively due to low voltage of the electricity. Further, the necessary actions had not been taken by the Madurawala Pradeshiya Sabha for meter readings, system maintenance, maintaining of books and records on money collected from the beneficiaries etc, at the planning stage of the Water Supply Scheme. Eventhough the Commissioner of Local Government of the Western Province and Provincial Project Director had explained that 03 officers of the respective Pradeshiya Sabha were deployed for water distribution and maintenance purposes, it was revealed at the site inspection that no any officers had been assigned for that purpose.

- (h) The contract to supply furniture for new library buildings constructed by the Project in the Western Province had been awarded at a cost of Rs. 22.64 million based on the technical proposals made thereon. Further, 158 book shelves valued at Rs. 2.51 million had only been supplied as at 31 December 2016. It was revealed at the later stages that the specifications made in the Bill of Quantities were prepared without assessing actual requirements and book shelves supplied were not suitable for the intended purposes.

3.4 Idle and under-utilized Assets

The following observations are made.

- (a) It was observed that the civil construction works completed and handed over to the Local Authorities were remained idle for long time. The administrative buildings constructed at a total cost of Rs. 402.24 million for Divulapitiya and Dodangoda Pradeshiya Sabhas in the Western Province, Rattota, Naula and Wilgamuwa Pradeshiya Sabhas in the Central Province and Galgamuwa, Thirappane and Ipologama Pradeshiya Sabhas in the North Central Province had remained idle for over 01 ½ years as at 30 June 2017, without being allowed to use of the general public.
- (b) In addition to the above, it was revealed at the site inspection that some parts of the buildings constructed by the Project were not used by the respective Local Authorities for intended purposes. Therefore, the auditoriums of the multi- purpose buildings constructed for Biyagama and Madurawala Pradeshiya Sabhas in the Western Province, Ayagama Pradeshiya Sabha in the Sabaragamuwa Province and Kandy Kadawath Sathara and Gangawata Korale Pradeshiya Sabhas in the Central Province had remained idle as at 30 June 2017. Further, stalls at weekly fairs constructed for Thissmaharama Pradeshiya Sabha in the Southern Province, Ayagama Pradeshiya Sabha in the Sabaragamuwa Province, Bandarawela Pradeshiya Sabha in the Uva Province and Kabithigollewa Pradeshiyaa Sabha in the North Central Province were remained idle as at 30 June 2017.
- (c) The Crematorium of the Wilgamuwa Pradeshiya Sabha constructed at a cost of Rs.16.51 million had remained under-utilized as there was low public demands. It was observed that the factors such as availability of lands in the area to use as burial grounds or cemeteries, low population density and the financial incapability of the people living in the area etc., had not considered at the time of arriving at the decision to construct the Crematorium.

3.5 Matter in Contentious Nature

It was observed that a multi- purpose building had been constructed at a cost of Rs. 43.91 million for Yatawattha Pradeshiya Sabha in the Central Province, eventhough the respective Pradeshiya Shabha had not made a request thereon and it evidenced that the priority needs of the Pradeshiya Sabha had not been considered.