

Strategic Cities Development Project - 2016

The audit of financial statements of the Strategic Cities Development Project 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 II (B) (3) of the Financing Agreement No.5428-LK dated 12 September 2014 and Additional Financing Agreement No. 5800 – LK dated 20 July 2016 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 and Implementing 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 initial estimated total cost of the Project amounted to 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. Further, according to the Financing Agreement No. 5800 –LK of 20 July 2016 for additional financing, the International Development Association had agreed to allocate SDR 39.90 million (US\$ 65 million) equivalent to Rs.7,975 million for the purpose of development works in Jaffna City.

The Project commenced its activities on 05 May 2014 and work scheduled to be carried out under the Loan is expected to be completed by 31 December 2019. The activities of the development works in Jaffna City under the additional financing arrangement are scheduled to be completed by 31 December 2021.

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 Credits 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 2016 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 Agreements.
- (f) Whether the withdrawals under the Credits had been made in accordance with the specifications laid down in the Financing Agreements.
- (g) Whether the funds, materials and equipment supplied under the Credits 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 Agreements 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 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 2016 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 Agreements,
- (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 Financial Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Non-compliance with Laws, Rules and Regulations

The Statement of Intermediate Result Indicators to be prepared by the Project, as required by the Section 10 of the Project Appraisal Document had not been prepared. Further, the Procurement Administration Manual to be prepared as described in the Section 24 of the Project Appraisal Document had also not been prepared, as enable to evaluate the progress on procurement activities of the Project based on the Procurement Performance Indicators prepared under the Section 33 (f) of the Project Appraisal Document.

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 in according to the Financing Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
IDA							
- 5428 LK	147.00	19,257.00	3,960.00	8.07	1,177.99	11.00	1,563.58
- 5800 LK	65.00	7,975.00	-	-	-	-	-
GOSL	45.08	5,905.48	1,850.00	3.08	446.99	4.09	559.72
Total	<u>257.08</u>	<u>33,137.48</u>	<u>5,810.00</u>	<u>11.15</u>	<u>1,624.98</u>	<u>15.09</u>	<u>2,123.30</u>

- (a) According to the above information, out of total allocation of US\$ 147 million equivalent to Rs. 19,257 million made by the Lending Agency, only a sum of US\$ 11 million equivalent to Rs. 1,563.58 million representing 07 per cent of the total allocation had been utilized as at 31 December 2016 after lapse of 02 ½ years from the commencement of the activities of the Project. Further, 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 the period of the Project had not been prepared and implemented. Therefore, the progress of utilization of fund allocated was remained slow.
- (b) 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. 1,624 million had only been utilized, out of the allocation amounting to Rs. 5,810 million made in the Budget Estimate for the year under review.

3.2 Physical Progress

According to the information received, the Project had taken action to implement several programmes to improve selected urban services and public urban spaces in Kandy and Galle Cities. However, the development activities in Jaffna City expected to be carried out under the additional financing arrangements had not been commenced even as at 31 December 2016. The following observations are made.

- (a) It was observed that meetings of the Project Steering Committee had not been held during the year under review. Further, 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) The reconstruction works of Katugastota- Madawala- Digana Road and Dharmashoka Road in Kandy commenced in July 2016 had shown slow progress of 27 per cent and 09 per cent respectively as at 31 December 2016 due to poor performance of the contractors. Further, the renovation works of underground drainage system in Kandy City with the length of 02 kilometres which scheduled to be completed as at 31 December 2016 was shown slow physical progress of 25 per cent as at that date.
- (c) The activities to be carried out and the procurements to be made for the use of Galle Municipal Council under the Institutional Strengthening and capacity Building Component of the Project had not been implemented during the year under review.
- (d) Eventhough 07 contracts to be carried out at an estimated cost of US\$ 4.07 million equivalent to Rs 609.72 million under the Sub Projects implemented in Kandy City which scheduled to be completed during the year under review, had not been completed even up to 31 March 2017 due to poor performance of the contractor.
- (e) Further, other 07 Sub- Projects which scheduled to be carried out in the Kandy City at a cost of US\$ 17.96 million equivalent to Rs. 2,690.11 million had been cancelled, as the concurrence of the International Development Association was not received. The new 04 Sub – Projects introduced thereon and scheduled to be completed during the year under review at a cost of US\$ 5.73 equivalent to Rs. 858.26 million had not been implemented.

3.3 Contract Administration

According to the progress reports, out of 76 contracts scheduled to be awarded at an estimated cost of US\$ 147 million equivalent to Rs. 22,020 million for rehabilitation works in Kandy and Galle Cities, 36 contracts valued at US\$ 34.65 million equivalent to Rs. 5,190 million had been awarded as at 31 December 2016. As a common feature, the construction works implemented by the Project had reported slow due to deficiencies such as selection of contractors without considering their financial feasibility, inadequate technical staff deployed by the contractors, inaccuracies in the designs prepared by the design consultants, delays in delivering of instructions from the Project were directly affected to the poor performance of construction works. The following further observations are made in this regards.

- (a) According to the contract agreements, the value of the interim bills should not be less than 05 per cent of the contract value. However, the bills related to rehabilitation works of Dharmashoka Road in Kandy and construction of gabion wall of Meda-Ela area which less than 05 per cent of the total contract values had been approved for payments without considering the conditions in the agreements.
- (b) Eventhough the Consultant had reported the poor progress of contractors engaged in civil construction works of Dunumadalawa Water Treatment Plant of the Project, action had not either been taken to expedite the performance of the contractor or terminate the contracts in terms of the contract agreements. Further, the action had not been taken to recover liquated damages amounting to Rs. 2.72 million from the contractor engaged in construction of Authors' Deck in Kandy City on delays in completion of works of 09 months.

3.4 Issues on Financial Controls

It was observed that only US\$ 8.07 million equivalent to Rs.1,177 million had been withdrawn during the year under review from the Special (Dollar) Account of the Project, out of the credit balance of US\$ 16.16 million equivalent to Rs. 2,348.22 million remained in the respective Account including the opening balance of US\$ 6.16 million equivalent of Rs.888.67 million and the imprest of US\$ 10 million equivalent to Rs. 1,459.55 million made on 10 June 2016. Therefore, the balance of US\$ 8.09 million equivalent to Rs. 1,324.56 million had remained unused in the Special (Dollar) Account as at 31 December 2016, due to poor forecasting of financial needs.

3.5 Uneconomic Transactions

According to the agreements entered by the Project on hiring of motor vehicles of maximum limit of 2500 kilometres per month is required to be run and additional charges is needed to be paid for excess kilometres. It was observed that a sum of Rs. 6.06 million had been spent by the Project on running of 157,052 kilometres in excess while several other motor vehicles had been performed below the maximum limit of 27,220 kilometres.

3.6 Underutilized Assets

It was observed that 09 motor vehicles procured by the Project in November 2016 at a cost of Rs. 73.55 million had remained at the premises of Kandy Municipal Council without being utilized up to 31 March 2017.

3.7 Human Resource Management

The following observations are made.

- (a) Eventhough the approved cadre of the Project consisted with 152 of officers for 13 posts, actions had not been taken to fill the vacancies remained in 75 officers including officers for 07 key posts of Additional Project Director, Deputy Project Directors over 02 years. Further, the vacancies of 22 officers for the post of Assistant Project Director had remained vacant for over 06 months as at 31 December 2016. The above mentioned shortages of staff had influenced mainly for the slow progress of implementing of the activities of the Project.
- (b) Further, the Project had deployed 02 Assistant Project Directors without having adequate experiences on handling of contract management and town planning activities. Further, the Project had not deployed officers with suitable qualification for social safeguard purposes in order to solve the issues on contract management and coordination with the people affected by the activities of the Project.
- (c) The Project had obtained services from 10 Local Consultants without having the approval of Department of Management Service and paid allowances of Rs. 20.52 million during the year under review.

3.8 Lands Acquisition

The following observations are made.

- (a) According to the initial plans of the Project 1,632 plots of land were scheduled to be acquired at an estimated cost of Rs.662 million and out of that 1,267 plots of lands had been acquired up to end of the year under review. The delays in acquisition of lands caused slow progress in implementing of the activities of the Project.

- (b) Out of the total cost of compensation on land acquired amounting Rs. 378.46 million, only a sum of Rs. 83.08 million had been paid as the statutory payments to be made under the Section 17 of Land Acquisition Act. The balance amount of Rs. 295.38 million had been paid based on the recommendations of the Land Acquisition Resettlement Committee. Further, additional payments aggregating Rs. 188.88 million had also been made to the same land owners who received compensation on concessionary basis. However, the reasons for the additional payments were not explained for audit.