

Local Government Enhancement Sector Project (Pura Neguma) - 2017

The audit of financial statements of the Local Government Enhancement Sector Project (Pura Neguma) for the year ended 31 December 2017 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 Nos. 2790-SRI(SF) of 21 October 2011 and 3431-SRI(SF) of 02 November 2016 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. The objective of the subsequent Loans of the Project is to improve the infrastructure and services delivered by the Local Authorities and National Water Supply and Drainage Board in less developed areas of 07 Provinces in Sri Lanka which affected by chronic kidney diseases. Therefore, the issues relating to the improvement of water supply systems, infrastructure, basic service delivery local government policy reforms and strengthening capacities are expected to be addressed. As per the initial 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 agreed to be financed by the Asian Development Bank. However, the agreed contribution of the Lending Agency had been determined subsequently as US\$ 52.04 million equivalent Rs.7,892 million, due to appreciation of United States Dollar against Special Drawing Rights. Further, the estimated total cost of the Project was determined as US\$ 67.84 million by the subsequent Loan Agreement and out of that US\$ 60 million (SDR 43.30 million) equivalent to Rs.8,700 million was agreed to be financed by the Asian Development Bank. 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. Further, the activities of the Project under the subsequent Loan Agreement are scheduled to be completed by 30 June 2020.

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 include 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 Loans 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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether withdrawals under the Loans had been made in accordance with the specifications laid down in the Loan Agreements.
- (f) Whether the funds, materials and equipment supplied under the Loans 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 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 2017 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2017 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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) the Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan 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 Loan Agreements 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 2017 are shown below.

Source	Amount agreed for financing in the Loan 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
ADB							
- 2790	59.00	7,670.00	1,050.00	6.89	1,048.75	51.27	7,221.13
- 3431	60.00	8,700.00	500.00	2.31	354.45	2.31	354.45
GOSL	17.57	2,401.10	342.00	2.07	314.98	10.03	1,417.90
Total	<u>136.57</u>	<u>18,771.10</u>	<u>1,892.00</u>	<u>11.27</u>	<u>1,718.18</u>	<u>63.61</u>	<u>8,993.48</u>

3.2 Physical Progress

According to the General Condition of the Project Preparatory Technical Assistance Report made under the Loan Agreement No 2790-SRI(SF), the Project had agreed to allocate a sum of Rs.50 million for selected Local Authorities each to construct their administrative buildings, improvements of infrastructural and other community facilities. According to the progress reports, the development works such as construction of 40 administrative buildings, development works of 21 infrastructural facilities, improvements of 89 community facilities and improvement of 25 water supply schemes and 03 other development works scheduled to be carry out in 161 Local Authorities had been completed as at 31 December 2017. However, the improvement works of 08 water supply schemes in the North Western, North Central, Uva and Central Provinces had only been commenced during the year under review, out of 64 water supply schemes scheduled to be carried out under the financial arrangements made under the Loan Agreement No. 3431-SRI(SF).

3.3 Contract Administration

The following observations are made.

- As a common feature, the quality failures of newly constructed buildings and other structures were revealed at the site visits made by the auditors during the period of audit. The cracks were appeared in 40 locations of the boundary wall constructed at the total cost of Rs.44.93 million at the premises of fish market of the Suriyawewa Pradeshiya Shabha in the Southern Province. Further, the defects of the buildings and other structures constructed by Karadeniya, Thissamaharama and Katuwana Pradeshiya Sabhas in the Southern Province and Kandy Kadawath Sathara and Gangawata Korale Pradeshiya Sabhas in the Central Province had also been highlighted in my report for the previous year. 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) It was observed that the works under the contract for construction of a building for a Library and Ayurvedic Medical Centre of Habaraduwa Pradeshiya Sabha in the Southern Province awarded on 18 August 2017 at an estimated cost of Rs 53.18 million had not been commenced even as at 31 December 2017. According to the information received, the Secretary of the Line Ministry had issued instructions at a meeting held on 23 February 2018 to reconsider the necessity of the respective building and suspended action to be taken to commence the works. It was observed that a sum of Rs.1.60 million had been spent as at 31 December 2017 on advertising and consultancy services thereon.
- (c) Eventhough, the procurement notices had been made in the newspapers on 30 June 2017 to call bids on construction of buildings for weekly fair of Bentota Pradeshiya Shaba, the bids had not been awarded even as at 31 December 2017, due to shortcomings observed in the bid documents. According to the explanations made by the Project Director, the action had been taken to recall the bids and awarded the contract in March 2018.
- (d) It was observed that the works under the water supply schemes of Uda Palatha Pradeshiya Sabha and Uda Dumbara Pardeshiya Sabha in the Central Province and Mihintale Pradeshiya Sabha and Thamankaduwa Pradeshiya Sabha in the North Central Province had been completed as at 30 June 2017 at a cost of Rs.399.13 million. However, action had not been taken by the contractors to hand over the water supply schemes to the respective Pradeshiya Sabhas even as at 15 May 2018.

3.4 Idle and under-utilized Assets

It was observed that several civil construction works completed and handed over to the Local Authorities were remained idle for long time without taking action to allow general public to use for intended purposes. The instances observed are described below.

- (a) The multi-purpose buildings constructed at a cost of Rs.50.77 million for the Naula Pradeshiya Sabha in the Central Province and the other buildings constructed for public bus stand and weekly fair of Lankapura Pradeshiya Sabha and Bulnewa Pradeshiya Sabha in the North Central Province at a cost of Rs.37.66 million had remained idle for over 01 ½ years as at 31 December 2017, without being allowed to use of the general public.
- (b) The water supply scheme of Wanathawilluwa Pradeshiya Sabha completed at a cost of Rs. 64.83 million had remained idle since the date of handing over as at 30 June 2017, due to lack of sources for continuous water supply. Further, 60 water tanks with the capacity of 5000 liters each and 74 water tanks with the capacity of 2000 liters each had been procured at Rs.58.32 million and distributed to 14 Grama Niladhari Divisions in the areas of Mahawa and Potipigama Divisonal Secretariats had remained idle since 30 June 2017, as there were no water bowers supplied to the respective Pradeshiya Sabhas for distribution purposes.

- (c) The public bus stands reconstructed at a cost of Rs.143.62 million in Rideegama and Mawathagama in the North Western Province and Kamburupitiya in the Southern Province had remained idle for over 06 months as at 31 December 2017, without being allowed to use of the general public. Further, the bus stand constructed at a cost of Rs.36.29 million at Kirama of Katuwana Pradeshiya Sabha in the Southern Province had remained idle since March 2016, due to lack of a proper access road.
- (d) The construction works of weekly fairs at Laggala- Pallegama and Rattota in the Central Province and Ayagama in the Sabaragamuwa Province completed at a cost of Rs.49.45 million had not opened for the use of general public over 1 1/2 years.
- (e) It was revealed at the site inspections that some parts of the buildings constructed by the Project were not used by the respective Local Authorities for intended purposes. Therefore, trade stalls at the weekly fairs and multi –purpose buildings constructed by Pelmadulla, Ayagama, Kahawatte Pradeshiya Sabhas in the Sabaragamuwa Province, Bandarawela Pradeshiya Sabha in the Uva Province, Walallavita Pradeshiya Sabhas in the Western Province, Ratthota Pradeshiya Sabha in the Central Province, Kebithigollewa Pradeshiya Sabha in the North Central Province had remained idle, due to lower demands of the general public. Further, the auditoriums at the multi – purpose buildings constructed by Galagedara, Gangawata Korale, Ambangagakorale and Ududumbara Pradeshiya Sabhas in the Central Province, Imbulpe, Kolonna, Kegalle, Rathnapura, Balangoda, Ayagama and Galigamuwa Pradeshiya Sabhas in the Sabaragamuwa Province, Biyagama, Walallawita and Madurawala in the Western Province, Lunugala and Haldummulla Pradeshiya Sabhas in the Uva Province and Palagala, Horowpathana, Nawagaththegama, Rabewa and Polpithigama Pradeshiya Sabhas in the North Western Province had remained idle for long time. It indicated that the respective Local Authorities had not taken action to identify the real needs of the area at the time of making their development proposals.

3.5 Issues on Financial Controls

The Project had not taken action to recruit an Internal Auditor to establish an Internal Audit Unit, as required by the Circular No. 02/2016 of 10 June 2016 of the Management Audit Department as enable to review the activities of the Project regularly.