

## **North East Local Services Improvement Project - 2017**

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The audit of financial statements of the North East Local Services Improvement Project 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 Schedule 2, Section II B of the Financing Agreement No.4728-LK dated 08 November 2009 and Grant Agreement No.TF 013787 dated 08 May 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 and Grant Agreements of the Project, then Ministry of Economic Development, presently the Ministry of Provincial Councils, Local Government and Sports is the Executing and Implementing Agency of the Project. The objectives of the Project are to improve the local services delivery mechanisms by Local Authorities in the Northern, Eastern, North Central, North Western and Uva Provinces in an accountable and responsive manner. As per the Agreements, the estimated total cost of the Project amounted to US\$ 107 million equivalent to Rs.12,942 million and out of that US\$ 70.70 million equivalent to Rs.8,530 million as a Loan and US\$ 20.30 million equivalent to Rs.2,540 million as a Grant was agreed to be financed by International Development Association. The balance of funds expected to be financed by the Government of Sri Lanka and through the contribution of the community. The Project commenced its activities on 01 May 2010 and scheduled to be completed by 31 December 2015. Subsequently, the period of the Project had been extended up to 31 August 2017. However, the financial statements of the Project had been prepared and presented for the year ended 31 December 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 errors.

### **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 judgement, 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 identifications of the purchases made out of the Credit and Grant,
- (d) Whether the opening and closing balances, withdrawals from and replenishments to the Imprest Fund 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 the withdrawals under the Credit and Grant had been made in accordance with the specifications laid down in the Financing and Grant Agreements.
- (f) Whether the funds, materials and equipment supplied under the Credit and Grant 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 Financing and Grant 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 Imprest Fund 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 replenishment in accordance with the requirements specified in the Financing and Grant Agreements, and
- (e) the financial covenants laid down in the Financing and Grant 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 as per the Financing and Grant Agreements		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>	
	US\$ million	Rs. million		during the year 2017	as at 31 December 2017
	US\$ million	Rs. million	Rs. million	Rs. million	Rs. million
IDA					
- Credit	70.70	8,530	1,000	994	9,448
- Grant	20.30	2,540	-	176	2,540
GOSL	14.00	1,662	200	32	1,643
Community Contribution	2.00	210	-	25	539
<b>Total</b>	<b><u>107.00</u></b>	<b><u>12,942</u></b>	<b><u>1,200</u></b>	<b><u>1,227</u></b>	<b><u>14,170</u></b>

### **3.2 Physical Progress**

According to the information made available, the infrastructure development activities such as road development, constructions of public parks and markets, rehabilitations of sewerage and drainage systems and rural electrification etc, implemented by the Project at a total estimated cost of US\$ 90 million equivalent to Rs.10,170 million under the Component -01 of the Project in areas under the purview of 101 Local Authorities in the Northern, Eastern, North Central, North Western and Uva Provinces had been substantially completed as at 31 December 2017.

### **3.3 Idle and Underutilized Assets**

It was observed at the site visits that the children parks constructed at Kondachchi, Silawatura, Veppamkulam, Mairichchukatti of Musali Pradeshiya Sabhas and Ujilankulam, Periyamadu and Vidaththaltheevu of Mannar Pradeshiya Sabha and market buildings constructed at Erratiperiyakulam, Mahakachchakodiya, Periyaulukkulam of Vavuniya Pradeshiya Sabha and the bus stand constructed at Silawatura in Musali Pradeshiya Sabha in the Northern Province constructed at a cost of Rs. 81.11 million had remained unutilized for over 4 years as at 31 December 2017, due to the respective constructions located at improper places which were not suitable for public usages.

### **3.4 Unsettled Audit Issues highlighted in the previous Audit Reports**

Eventhough the following observations are made in my previous audit reports, adequate actions had not been taken to investigate matters and identify the responsible officers thereon.

- (a) The meaningful action had not been taken against the parties responsible for fraudulent payment of Rs. 4.42 million made in 2015 by alteration of rates in the bid documents by 03 Local Authorities in the Northern Province, eventhough a sum of Rs. 1.5 million had been paid from the Provincial Fund to conduct inquiries in this connection.
- (b) The Project Engineer had functioned as the Chairman of the Technical Evaluation Committees for selection of bidders for rehabilitation works carried out by Vavuniya South Sinhala Pradeshiya Sabha and offered such contracts at a cost of Rs. 4.2 million to his own company and no action had not been taken against the parties responsible thereon.

### **3.5 Closure of the Activities of the Project**

Eventhough the activities of the Project had been closed as at 31 August 2017, necessary instructions had not been issued by the Executing Agency to the Project Monitoring Unit to prepare financial statements for winding up purposes.