

Local Government Enhancement Sector Project (Pura Neguma) - 2019

The audit of financial statements of the Local Government Enhancement Sector Project (Pura Neguma) for the year ended 31 December 2019 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 Article IV of the Loan Agreements No. 2790-SRI(SF) dated 21 October 2011 and 3431 –SRI(SF) dated 02 November 2016 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. My comments and observations which I consider should be reported to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, the Ministry of Internal and Home Affairs and Provincial Councils and Local Government is the Executing Agency and Provincial Councils of 07 Provinces are the Implementing Agencies of the Project. The objectives of the Project are to achieve improved Local Government Infrastructure Activities of the Project and effective delivery of services through accountable and financially and technically strengthened local authorities. The subsequent loans of the Project had been allocated 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 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 Loan Agreement 2790-SRI(SF), the estimated total cost of the Project was US\$ 68.80 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 Asian Development Bank. The balance of the estimated cost of US\$ 19.8 million contributed by the Government of Sri Lanka. As per the subsequent Loan Agreement No.3431 SRI (SF), additional Loan of US\$ 60 million was obtained in the year 2017 to scale up well performance of the original Project. The estimated Project cost is US\$ 67.8 million with the contribution of Government of Sri Lanka. The Project had commenced its activities on 01 July 2012 and scheduled to be completed by 30 June 2015. However, the date of completion of the activities of the Project had been extended up to 31 December 2021.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019 and its cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Generally Accepted Accounting Principle, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Non-compliance with Laws, Rules and Regulations

Reference to the Laws, Rules and Regulations	Non-compliances	Impacts	Responses of the Management	Auditor's Recommendations
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Paragraph 6.1 of Management Service Circular No.1/2019 of 15 March 2019	<p>Project Staff is allowed for one short-term training. However, Project Director, Deputy Project Director and one Senior Engineer had participated more than one foreign training program.</p> <p>Further, the Project Steering Committee may recommend this training on ground that it is necessary to carry out duties of the Project. It was observed that project staff and Ministry staff was engaged to foreign training without recommendation of Steering Committee.</p>	<p>Opportunities of other members in project staff were deprived.</p> <p>Intended benefit to the Project had not been received.</p>	No Comments	Need to comply with the Circular instruction.
Paragraph 6.2 of Management Service Circular No.1/2019 of 15 March 2019	<p>Selection should be strictly based on project needs. However, staffs of the Ministry engaged to foreign training are not involved to activities of the Project.</p>	<p>Intended benefit to the Project had not been received.</p>	Project staff was selected based on duty and selection of other staff made by the Ministry.	Need to comply with the Circular instruction.
Paragraph 9.3 of Management Service Circular No. 1/2019 of 15 March 2019	<p>The Meetings of the Project Steering Committee are required to be held once in 02 months. However, only 03 meetings had been held during the year under review.</p>	<p>The monitoring activities of the Project may not be carried out effectively.</p>	No Comments	The meetings of the Project Steering Committee are required to be held as per the Circular instruction.

President
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Circular
No.PS/1/1/16/1

A report should be submitted after foreign training by every participant. However, above report had not been submitted.

Intended benefit to the project had not been received.

The reports were not submitted by some of the participants.

Need to comply with the Circular instruction.

3. Physical Performance

3.1 Physical Progress of the Activities of the Project

According to the Project Implementation Plans, the Project had supported to 105 Local Authorities in 07 Provinces to enhance their infrastructural requirements and respective development works of 178 Local Authorities had been completed at the end of year 2017. Further, it was scheduled to carry out 29 water supply projects, 35 construction works in 29 Local Authorities under the supplementary loan facilities and out of that 04 water supply projects were completed at the end of the previous year. 3 water supply projects and 11 infrastructure Projects were completed during the year under review. The issues relating to the physical progress of such projects are given below.

Nos	Activities	Physical performance as at 31 December 2019		Delays in Months	Impacts	Comments of the Management	Auditor's Recommendations
		Expected	Achieved				
		-----	-----	-----	-----	-----	-----
		%	%				
<u>Water supply sub projects</u>							
(a)	Minneriya water treatment plant improvement project	100	80	30	(a) Over running of cost estimates (b) Expected benefits not received by the intended parties	Mutually terminated due to technical reasons at a progress of 80% with the approval of the National Steering Committee and to complete balance works advertisement had been made as separate contract.	The project is required to make influences to the contractor to complete the civil works promptly assuring the required level of quality.

(b)	Capacity improvement to Nuwarawewa water treatment plant.	77	55	03	(a) Over running of cost estimates (b) Expected benefits not received by the intended parties	Poor performance mainly liquidity problem of the contractor.	The project is required to make influences to the contractor to complete the civil works promptly assuring the required level of quality.
(c)	Extension of Pipelines to Sewagama Canel 3 area and transmission main extension up to Sewagama water tower.	94	73	17	-Do -	Delay in importing DI pipes	-Do -
(d)	Extension of water supply scheme at Nikaweratiya	85	75	17	-Do -	-Do -	-Do -
<u>Civil construction works</u>							
(e)	Construction of new multipurpose building at Kurunegala	75	75	03	-Do -	Initial delay due to soil permits	-Do -
(f)	Construction of PS office building Narammala	100	65	05	-Do -	Poor Performance of the contractor due to cash flow problem	-Do -
(g)	Construction of new market complex at Polgahawela	100	80	06	-Do -	Poor Performance of the contractor due to cash flow problem	-Do-

(h)	Kurusawaththa drinking water supply project	36	36	04	(a) Over running of cost estimates (b) Expected benefits not received by the intended parties	No comments.	The project is required to make influences to the contractor to complete the civil works promptly assuring the required level of quality.
(i)	Construction of Maternity & Health care Centre and Community Hall for Matale PS	93	84	06	-Do -	No Comments.	-Do -
(j)	Construction of Maternity Care Centre at Kurukuththala	100	81	05	-Do -	Location is in a very difficult terrain.	-Do -
(k)	Construction of Auditorium Kadirana	85	65	06	-Do -	Foundation redesigned due to a mistake made by the National Building Research Organization during soil investigation.	-Do -
(l)	Construction of Multipurpose buiding with market - Mahabage	95	91	10	-Do -	All works completed except painting and fixing fittings.	-Do -

3.2 Delays in Commencement of the Activities of the Project

The following observations are made.

Nos	Activities	Date of commencement	Delaying Months	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	Improvement of Kalawewa Treatment Plant	15 March 2019	24	(a) Delays in completion (b) Over running of cost estimates (c) Expected benefits not received by the intended parties	No Comments.	Possible increases of costs of the contracts and unnecessary time extensions need to be avoided.
(b)	Kebithigollewa Water supply scheme	19 September 2019	28	-Do-	No Comments.	-Do-
(c)	Extention of Water supply for Dambulla rural area and Kandalama	28 February 2019	22	-Do-	No Comments.	-Do-
(d)	Construction of Water supply extension to Inamaluwa and Kithulhitiyawa	02 January 2019	21	-Do-	No Comments.	-Do-
(e)	Construction of Water supply extension to	02 January 2019	21	-Do-	No Comments.	-Do-

	Sigiriya and Habarana areas					
(f)	Supply and laying distribution network in Bathalayaya and Belaganwewa	17 January 2019	21	(a) Delays in completion (b) Over running of cost estimates (c) Expected benefits not received by the intended parties.	No comments.	Possible increases of costs of the contracts and unnecessary time extensions need to be avoided.
(g)	Bathalayaya and Belaganwewa treatment plant	17 January 2019	21	-Do-	Delays in implementation of bid evaluation process.	-Do-
(h)	Construction of Multi-purpose building at Madurankuliya	27 January 2019	21	-Do-	No Comments.	-Do-
(i)	Improvement of kekunadura sub town	08 March 2019	23	-Do-	waiting for cabinet approval	-Do-
(j)	Construction of Crematorium	01 March 2019	23	-Do-	No Comments.	-Do-
(k)	Construction of public Market	11 March 2019	23	-Do-	ADB concurrence awaited	-Do-

3.3 Contract Administration

The following observations are made.

Nos	Audit Issues -----	Impacts -----	Response of the Management -----	Auditor's Recommendations -----
(a)	The performance bond had not been encashed in time to recover the Liquidity Damage charge amount Rs.1.78 Million from the Contractor.	The government has been lost Rs.1.8 Million due to not encashed performance bond before the date of expiry.	As a summery the contractor has to pay back a total of Rs.1,789,776.22 to the project and also there are significant number of permanent defects which should be considered as sub-standard quality works performed by the contractor under the improper supervision of Design and supervision Consultant. Now these permeant defects can only be corrected by redoing the work with additional cost.	Action should be taken against the neglectful officials.
(b)	Udapalatha Pradeshiya Sabha has refused to take over the water supply Scheme due to defects in the construction. Eventhough supplementary contract was awarded to same contractor at the cost of Rs.9.3 Million in order to rectify but the defects. The works had not been completed up to now.	The Rs.9.3 Million has been lost to the state due to negligence of the project officials and intended benefits had not been reached to the public	No Comments.	Action should be taken against the neglectful consultants and project officials involved.

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| (c) | The three water supply schemes at the cost of Rs.282.36 Million in Udapalatha, Ududumbara and Wilgamuwa Pradeshiya Sabhas implemented under the Puraneguma original fund have been remained underutilized. In order to rectify defects of those projects new contract has been awarded at the cost of Rs102 Million under the additional Financing. | The Rs.102 Million has been lost to the state due to negligence of the project officials further intended benefits had not been reached to the public | No Comments. | Action should be taken against the neglectful consultants and project officials involved. |
| (d) | After handing over the Ibbagamuwa water supply scheme to National Water Supply & Drainage Board there were pipe burst occurred in four instances at four places. | In case of any deficiency arise after ending the defect liability period it will be an additional burden to the Government. | The pressure test had done on 08.11.2019 with presence of National Water Supply & Drainage Board officials and consultant's officials. | The action should be taken to obtain a certificate from National Water Supply & Drainage Board. |
| (e) | It was observed that after rectifying the defects of Ibbagamuwa water supply scheme, testing of pressure has been done without being presence of officials of the NWSDB. | -Do - | -Do - | -Do - |
| (f) | The contractor had allowed to use new 110mm PVC pipes for Galewela Thithhawelgolla water supply extension contract. It was observed at the physical verification that the damaged & discolored 1314 No's of 110 mm PVC pipes stored in a site to use for this contract & out of these stocks 186 No's pipes were used for laying. | The intended results will not be achieved due to less durability | Consultant said that damaged & discolored PVC pipes had not been used. | Action should be taken to remove damaged pipes. |

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| (g) | The key positions for the posts of Experts deployed by the firm of consultant involved in the works in the Southern Province had remained vacant and the reports on Conceptual Drawings, Detail Architectural Drawings, Detail Structural Drawings, Detail Service Drawings, Preparation of the Specification for the Works and Materials, Preparation of the Financial Environmental and Social Reports etc., under 07 projects out of 10 projects had not been submitted. | The activities of the Project will be completed with delays | ADB concurrence had been received based on the cordial relationship maintained by the Project. | Action should be taken against the firm of Consultant instead of taking action against the Team Leader |
| (h) | Although a building permit is required to obtain the approval of the plan before constructing the building according to the Urban Development Authority Act No. 41 of 1978 (Section 03), the approval had not been obtained for Geliyoa Public Market and the car park and Kurukuttala Maternity and Child care clinic Centre of Udunuwara Pradeshiya Sabha. | Construction may not be compatible to the minimum requirements and city's general development program | No comments. | Must comply with the rules. |

3.4 Idle/ Unutilized/ Underutilized Resources

The following observations are made.

(I) IT Solution for Local Authorities Idle Assets

Audit Observation	Impacts	Response of the Management	Auditor's Recommendations
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The IT solution has been implemented known as “Front Office System” providing with hardware for 137 Pradeshiya Sabas by the project. It was observed that the intended objective could not achieved due to non-availability of back office system in order to support to newly introduced Front Office System. It was further revealed that out of 41 Local Government Institutions available in Central Province and North Central Province, 17 Pradeshiya Sabas have not practiced totally the above system and 16 Pradeshiya Sabas have purchased new alternative software without implementing above system.	The system relating to the information of local authorities had not been achieved the target. As a result the intended benefit to the people living in area had not been received.	The project is required to make influence to officers to develop the system.	The responsibilities of the implementation of project activities to be assigned to Provincial Project Directors.

(II) Civil and Water supply projects

Nos	Audit Observation Idle Assets	Impacts	Response of the Management	Auditor's Recommendations
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(a)	Water Supply system at Wanathawilluwa	No water supply facilities for 4,333 families in the area	As agreed the Pradeshiya Sabha had been taken necessary actions thereon	Intended objectives of the Project should be reached in order to provide facilities to the beneficiaries
(b)	Multipurpose building and the Bus Stand at Redeegama	Intended benefits had not been reached	All construction work under the project were completed and after completion of	-Do-

			constructions work agreed by P.S has planned to open for public	
(c)	Bus stand at Mawathagama	Intended benefits had not been reached to the general public	Bus stand constructed at Mawathagama. not commenced its operations	Action should be taken to utilize the Buildings constructed.
(d)	Water Supply system at Polpithigama	No water supply facilities for 1,700 families in the area	Action had been taken to procure the Water Bowser for Polpithigama Scheme.	Action should be taken to achieve intended objectives.
(e)	Bus stand at Meegahakiula	Intended benefits had not been reached to the general public	Actions are being taken to construct the access road.	Action should be taken to support to the Pradeshiya Sabha to construct access road in order to use the Bus stand.
(f)	Weekly Fair, Multipurpose building, Lavatories, Water Supply System at Bandarawela Pradeshiya Sabha	Intended benefits had not been reached to the general public	Building constructions have been completed and handed over to Pradeshiya Sabha and Ministry has directed Pradeshiya Sabha to commence operations without delay. It is responsibility of relevant authorities to use these building for the intended purpose.	Action should be taken to provide necessary facilities to use the building and other development works for intended purposes.
(g)	Weekly fair at Rathtota PS	Intended benefits had not been reached to the general public.	Pradeshiya Sabha decided to sub divide stall as per request made by the vendors. The weekly fair will commence operations with the completion of the sub divisions of the stalls	Action should be taken to use the building for intended purposes
(h)	Bus stand at Kirama	Intended benefits had not been reached to the general public	Action had been taken to construct two access roads for the bus stand	Action should be taken provide necessary facilities to use the Bus stand

(i) Crematorium at Wilgamuwa	Intended benefits had not been reached to the general public	Building constructions have been completed and handed over to Pradeshiya Sabha and Ministry has directed Pradeshiya Sabha to commence operations without delay and it is responsibility of relevant authorities to use these building for the intended purpose	Necessity of the construction of Crematorium at Wilgamuwa area should be properly evaluated and avoid wasting of funds provided by the Project.
(j) Water supply scheme at Wilgamuwa	No water supply facilities for 350 families in the area	Action had been taken to rectify.	Action need to be taken to consult the specialists and rectify the errors.
(k) Water supply scheme at Diklanda	Intended benefits had not been reached to the general public	Action had been taken to change treatment plant as instructed by the National Water Supply and Drainage Board.	Action should be taken to use the assets intended purpose.
(l) Comfort Centre - Ipalogama	Intended benefits had not been reached to the general public	Action will be taken to implement the Project after completion of water supply scheme	Prompt action should be taken

3.5 Activities of the Project not commenced

The following sub projects had to be commenced before April 2017 however the sub projects had not been commenced up to 30 June 2020.

Nos	Activities	Estimated Value Rs. Million	Impacts	Response of the Management	Auditor's Recommendations
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(a)	Water supply scheme for Thanamalvila and Hambegamuwa distribution system	1,270	Expected benefits not received by the intended parties	Lack of water resource	Sub project should be commenced as soon as possible or work schedules in Project Administration Manual should be revised
(b)	Water Treatment plant for Thanamalvila and Hambegamuwa scheme	430	Expected benefits not received by the intended parties	Lack of water resource	Sub project should be commenced as soon as possible or work schedules in Project Administration Manual should be revised
(c)	Construction of Water Supply Scheme at Karuwalagaswewa	275	-Do-	To be awarded	-Do-
(d)	ThreeWater supply scheme at Kebithigollewa	70	-Do-	One project already commenced	-Do-
(e)	Construction of Borehole pump house and chlorinators – Central Province (Three numbers)	60	-Do-	No comments	-Do-
(f)	Intake tank for Thanamalvila and Hambegamuwa scheme	100	-Do-	Lack of water resource	-Do-

(g)	Construction of PS Building at Kotagala	50	-Do-	Drop due to land issue as advised by National Steering Committee	-Do-
(h)	Construction of PS Building at Argarapathana	50	-Do-	Drop due to land issue as advised by National Steering Committee	-Do-
(i)	Extension of water treatment plant at Bathalayaya and Belaganwewa	389	-Do-	To be awarded	-Do-
(j)	Passara water supply project	434.71	-Do-	Agreement signed	-Do-
(k)	Construction of Multi-Purpose Building	50	Expected benefits not received by the intended parties	Awaiting ADB approval for awarding	Sub project should be commenced as soon as possible or work schedules in Project Administration Manual should be revised

3.6 Matters in Contentious Nature

The following observations are made.

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendations -----
A Sub Project was implemented for seven Pradeshiya Sabhas in seven provinces under a contract agreement signed on 15 th December 2018 with an Australian private company. The objective of this sub project is to create Assets Management Software as a Pilot Project. It was observed that foreign private company was selected for this contract without procurement	The pilot project resumed at cessation stage of the project has been result to wasting public fund.	The activity is processed to mandate of the project and procurement notice published in the ADB website.	The project is required to make influences to contractor to complete the work promptly assuring required quality.

practices required by the National Procurement Agency Circular No.08 and dated on 25 January 2006. It was further revealed that there was no provision in the above agreement for support and maintenance system of the above software. Further, no feasibility study was done by studying existing rules and manuals in the Local Government sector in Sri Lanka. As per the work plan in the above agreement, the activities installation and “Develop Training Material and complete staff training” has not been completed as planned as at 31 December 2019.