

Colombo Urban Regenerations Project - 2020

The audit of financial statements of the Support to Colombo Urban Regenerations Project for the year ended 31 December 2020 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 04 Annexure – 01 of the Loan Agreement No. L0081A dated 25 April 2019 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Infrastructure Investment 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 Urban Development, Water Supply & Housing Facilities is the Executing Agency and Urban Development Authority is the Implementing Agency of the Project. The objectives of the Project are to improve housing conditions of law-income communities and increase land use efficiency in Colombo through investment in the construction of affordable housing and redevelopment of land, with associated policy and system enhancements. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 287 million equivalents to Rs. 50,460 million and out of that US\$ 200 million equivalents to Rs. 35,163.7 million was agreed to be financed by the Asian Infrastructure Investment Bank (AIIB). The balance amount of US\$ 82 million equivalents to Rs. 14,417.2 million and US\$ 5 million equivalents to Rs. 879.1 million agreed to be financed by the Government of Sri Lanka (GOSL) and the private partner respectively. The Project commenced its activities on 22 July 2019 and scheduled to be completed by 30 June 2025.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 2 of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2020 and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for Qualified 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 Sri Lanka Accounting Standards 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 scepticism 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 Accounting Deficiencies

	Accounting Deficiencies	Amount Rs. million	Management Responses	Auditor's Recommendations
(a)	Loan interest aggregating of US\$ 41,059 equivalent to Rs. 7.6 million directly charge by the AIIB for the year 2019 and 2020 had been accounted under the commitment fee without being separately shown as interest charges.	7.6	The mistake will be adjusted to the relevant accounts in 2021.	The commitment changes and interest should be separately shown in the financial statements.

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| (b) | Commitment charges of US\$ 196,863 equivalent to Rs.35.4 million and interest charges of US\$ 6,248 equivalent to Rs. 1.1 million directly charge by the AIIB relating to financial year 2019 had been brought to the financial statements as current year's transactions without being adjusted as a prior year adjustment. | 36.5 | The mistake will be adjusted to the relevant accounts in 2021 | Expenditure should be recorded in the respective financial years. |
| (c) | Balance of the proceeds from the Loan had been overstated in the financial statements, due to the erroneous accounting treatment made for disbursements that made from the Loan, interest and commitment charges. | 82.8 | The adjustment will be made to the relevant accounts in 2021 | The actual situation of the loan disbursement should be shown in the financial statements. |
| (d) | Exchange loss of Rs.16.3 million had not been brought to the financial statements during the year under review in terms of LKAS 21. | 16.3 | The adjustment will be made to the relevant accounts in 2021 | The exchange loss/gain should be adjusted in the financial statements according to the LKAS 21. |

2.2 Non- compliance with Laws, Rules and Regulations

Reference to the Laws Rules and Regulations	Non- Compliances	Management Responses	Auditor's Recommendations
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(a) Schedule II, 3 (a) and (b) of the loan agreement	Although the consultants had to be appointed not less than 6 months after the commencement of the project to carry out the basic functions of the project, it had failed to comply with that requirement.	Identifying the subject area to obtain consultancy services for this and subject area preparation has begun.	This function needs to be done at the beginning of the project in order to carry out the development functions.
(b) Management Service Department Circular No.01/2019 dated 03 March 2019	An Internal Auditor had not been appointed as per the Circular up to end of June 2021.	Recruitment of Internal Audit posts is in progress.	In order to strengthen the project activities, internal audit functions should be carried out.

- (c) Section 4.09 of the General Condition of the Loan Agreement dated 25 April 2019. Eventhough the Borrower should be maintained a financial management system through the Ministry and the UDA, such a system had not been introduced even up to end of the year under review. Preliminary work to establish a financial management system was initiated in 2020, but it was delayed due to the Covid-19 situation in 2020. All work is being expedited to complete before the end of July 2021. A financial management system should be implemented as early as possible.
- (d) Schedule 2, Section 1 (A) (2) of the Loan Agreement. According to the project agreement, all-representative steering committee should be establish within six months from the date of commencement of the project, but no evidence has been submitted to audit for the establishment and implementation of such a committee. Two regulatory committees have been set up in accordance with paragraph 2 of Schedule 2 to Phase 1 of the loan agreement. Reports submitted to the Audit. Regulatory committees should be held in order to run the project as per the implementation plans.
- (e) Schedule 2 of the loan agreement (the environmental and social requirements). Environmental and social management planning framework and resettlement policy framework should be prepared by the project before implementation of the project. However, such policies had not been formulated by the project. Two resettlement plans for Obeysekarapura Madampitiya lands have been prepared and approval has been obtained. In accordance with the loan agreement, those policy frameworks should be formulated.

3. Physical Performance

3.1 Physical Progress of the Activities of the Project

	Activity	Date scheduled to be commenced	Date of Implementation /completion	Delay	Managem ent Response	Auditor's Recommendations
(a)	Selection of contractors for the construction of 700 housing units in Madampitiya project.	Selection to be done before 31 December 2020	Contract for Madampitia Project had been Awarded on 07 April 2021.	3 month	This delay is due to Covide-19.	The scheduled works should be commenced according to the Plans.
(b)	obtained the Consultancy Services for the	Selection to be done before 31 December 2020	The Consultants for the Madampitya and	5 months and 2.5 months	This delay is due to Covide-	The scheduled works should be commenced

Madampitiya and Ferguson project.

Ferguson Projects had been selected on 20 May and 16 March 2021 respectively.

respectively according to the Plans.

3.2 Contract Administration

----- Audit Issue -----	Management Responses -----	Auditor's Recommendations -----
(a) The approval of the Environmental Advisory Committee should be obtained before selecting the contractors for the construction of the building and to start the project. However, without obtaining those approvals, a contractor had been selected for the construction works of the Stadiumagama, Obeysekarapura and Applewatta projects and a sum of Rs. 984 million had been paid on 06 April 2021 as mobilization advance.	By June 15, 2021, Stadiumagama and Obeysekerapura Projects have completed the Environmental Advisory Committee Report and submitted it to the Urban Development Authority.	Approval of the Environmental Committee should be obtained before commencement of the projects.
(b) The approvals which are required to obtain before commence the constitution works had not been obtained.	Approval has been delayed due to the impact of the Covid - 19 environment.	Relevant approvals should be obtained before starting a project, in order to minimize the risks.
(c) According to the performance report submitted by the Technical Division of the project, a contractor was selected for the construction of 700 housing units in Applewatta project on 31 December 2020 and a sum of Rs. 155.6 million had been paid as the mobilization advance on 26 January 2021. However, the consultants had not been selected for the project until 26 January 2021. As a result, initial important works had been carried out without being supervised by the Consultants.	Awarded to an Institute for Specialist Services on March 16, 2021. Preliminary work was done by the architects and engineers attached to the project.	Specialist services should be obtained before starting projects.
(d) Mobilization Advance totaling Rs. 595 million had been paid based on a request made by the contractor of the Stadium Village Housing Project consists of 1000	Payments have been made in accordance with the agreement entered into with the Contractor	All the payments within the country should be made in Sri Lankan Rupees

houses proposed to be constructed. However, while paying Rs.357 million by in Sri Lankan Rupees, Rs. 250 million had been paid at a rate of Rs. 176.00 per US\$, instead of being made the payment of Rs.238 million at the spot rate. As a result, a sum of Rs. 12.4 million had been over paid to the contractor.

as per the Government Procurement Guidelines.

3.3 Extraneous Activities/Payments made out of the Project objectives

Audit Issue -----	Response of the Management -----	Auditor's Recommendation -----
In addition to the UDA expenses incurred, a sum of Rs.9.3 million had been incurred by the project for the participated delegation, 15 officers for the loan negotiations and that expenditure had been capitalized under the GOSL allocation.	Through this participation, they discussed the terms of the agreement and acted effectively on behalf of the Government of Sri Lanka.	Expenditure of the project should be minimizing as much as possible without incurring unproductive expenses.

3.4 Issues Related to Human Resources Management

The following observations are made.

- (a) In order to function the project efficiently, the project must have a full-time staff, but out of the 66 approved cadre of the project, 7 officers of the Urban Development Authority (UDA) had been appointed as the top management on an acting basis, other than the project director.
- (b) A proper Personnel Management System should be maintained for the effective operation of the project, but out of the 66 employees approved for the project, 53 remained vacant as at 31 December 2020.

3.5 Issues relating to the Land

Expected to be acquired -----	No of plots of land ----- Acquired as at 31 December 2020	Ownership transferred -----	Management Response -----	Auditor's Recommendation -----
Eleven plots of land extent of 111.5 acres proposed to be redeveloped	According to the overall project implementation plan, out of the 11 plots of land, 04 plots land	Prior to the release of the proposed resettlement	Land is expected to be developed under the PPP model. Further, proposals have been submitted to the AIIB	The land development activities should be completed according to the

with the extent of homeowners had for land development implementation
37.5 acres scheduled to be identified not only for plans.
to be developed and necessary resettlement vacant land
during the year 2020. plans scheduled development activities
However, it was not to be completed but also to increase the
completed even upto by 2020. efficiency of use of
end of May 2021. However, this vacant government
had not been lands.
done even up to
10 June 2021.