

**Dry Zone Urban Water and Sanitation Project (Loan No.2477-SRI/2977-SRI,Grant No.0129/030 SRI) - 2013**

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The audit of Financial Statements of the Dry Zone Urban Water and Sanitation Project for the year ended 31 December 2013 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 2.09 of Article II of the Project Agreement No. 2477 SRI (SF) dated 29 June 2009 and 2977-SRI (SF) dated 13 February 2013 entered into between the National Water Supply and Drainage Board (NWSDB) and the Asian Development Bank (ADB).

**1.2 Implementation, Objectives, Funding and Duration of the Project**

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According to the Loan Agreement of the Dry Zone Urban Water and Sanitation Project the NWSDB under the Ministry of Water Supply and Drainage is the Implementing Agency of the Project. The objective of the Project is to improve physical wellbeing of the urban populations in Sri Lanka's north western dry zone, which include, Mannar and Vavuniya Districts in the Northern Province and Puttalam and Chillaw Districts in the North Western Province. As per the Project Agreement, the estimated total cost of the Project is US\$ 163.33 million and out of that US\$ 123 million or 75.31 percent was agreed to be financed by the ADB. The ADB has agreed to make a grant of US\$ 2 million or 1.22 percent from the Netherlands Trust Fund (NTF) for the Water Financing Partnership Facility and remaining balance of US\$ 38.33 or 23.47 percent was agreed to be financed by the Government of Sri Lanka (GOSL). The Project commenced its activities on 13 November 2009 and scheduled to be completed by 30 June 2013. The cost of the Project initially decided had increased by US\$ 50 million due to increase in input requirements for civil works and equipment and increase of taxes and duties as estimated during detailed design. The additional financing of US\$ 40 million had been approved by the ADB on 18 December 2012 and the completion date of the project had also been extended up to 30 June 2016.

**1.3 Responsibility of the Management for the Financial Statements**

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Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatements, whether due to fraud or error selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

**2. Scope of Audit and Basis of Opinion**

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My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as enable as wide and audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and

significant estimate made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion. The audit examination also included such test of systems and controls, transactions, assets, liabilities and accounting records 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 adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the GOSL 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 Loan / Grant etc.
- (c) Whether the withdrawals under the Loan/Grant had been made in accordance with the specifications laid down in the Loan /GrantAgreement.
- (d) Whether the funds, materials and equipment supplied under the Loan / Grant had been utilized for the purposes of the Project.
- (e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (g) Whether the opening and closing balances, withdrawals from and replenishments to the Imprest Fund Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (h) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (i) Whether the financial covenants laid down in the Loan / grant Agreement had been complied with

### **3. Opinion**

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So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 5 of this report , I am of opinion that,

- (a) The Project had maintained proper accounting records for the accounting year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles.

- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the statements of expenditure ( SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan /Grant Agreements and
- (e) The financial covenants laid down in the Loan/Grant Agreements had been complied with.

#### 4. Financial statements

##### 4.1 Financial Performance

According to the financial statements and information made available, the Project expenditure for the year ended 31 December 2013 amounted to Rs. 1,037,201,249 and the cumulative expenditures at 31 December 2013 amounted to Rs. 2,432,299,197. A summary of the expenditure for the year under review, expenditure for the preceding year and the cumulative expenditure as at 31 December 2013 is shown below.

Item	Expenditure for the year ended 31 December		Cumulative Expenditure as at 31 December 2013
	2013	2012	
	Rs.	Rs.	Rs.
Work -in - progress	1,031,541,132	854,765,289	2,373,981,772
Property, Plant and Equipment	5,660,117	25,662,163	58,317,425
	<b>1,037,201,249</b>	<b>880,427,452</b>	<b>2,432,299,197</b>

##### 4.2 Imprest Fund Accounts

According to the books and records maintained by the Project and the information made available, the operations of the Imprest Fund Accounts for the year ended 31 December 2013 are given below.

###### (1) Loan No – 2477 (ADB)

	US\$	Rs
Balance as at 1 <sup>st</sup> January 2013	12,677	1,612,015
Add: Replenishment	820,225	106,413,032
	<b>832,902</b>	<b>108,025,047</b>

<b>Less :Withdrawals</b>	617,927	80,015,218
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	214,975	28,009,829
Exchange difference	-	98,741
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Balance as at 31 December 2013	<b>214,975</b>	<b>28,108,570</b>
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(II) **Grant No -129 (ADB)**

	US\$	RS
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Balances as at 1 <sup>st</sup> January 2013	1,187,757	151,036,049
<b><u>Add:</u></b> Replenishments	1,286,800	168,136,271
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	2,474,557	319,172,320
<b><u>Less:</u></b> Withdrawals	1,792,084	232,021,797
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	682,473	87,150,523
	-	2,084,902
Exchange difference		
Balances as at 31 December 2013	<b>682,473</b>	<b>89,235,425</b>
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(III) **Grant No -130 (NTF)**

	US\$	RS
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Balance as at 1 <sup>st</sup> January 2013	141,255	17,962,084
<b><u>Add:</u></b> Replenishments	73,445	9,611,929
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	214,700	27,574,013
<b><u>Less:</u></b> Withdrawals	29,955	3,909,534
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	184,745	23,664,479
Exchange difference	-	491,430
Balance as at 31 December 2013	<b>184,745</b>	<b>24,155,909</b>
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5. **Audit Observations**

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The following observations are made.

- (a) Expenses incurred from GOSL funds during the year 2008 amounting to Rs. 7.8 million could not be satisfactorily vouched in audit due to non-availability of vouchers and relevant supporting documents. Even though this position was

reiterated in my previous years audit reports action had not been taken by the management to rectify this issue.

- (b) Assets procured by the project for NWSDB in 2012 and 2013 for Rs. 546,271 and Rs. 1,445,348 respectively. In the financial statements as receivable from the NWSDB but action had not been taken to recover those balances even up to 30 June 2014.
- (c) Although a sum of US\$ 57 million had been provided for in the Loan and Grant Agreements to procure of construction equipment, materials and office equipment, the GOSL funds of Rs. 12,213,794 had been utilized by the Project during the period of 2009 to 2013 for that purpose.
- (d) The accounting policy for borrowing cost had not been disclosed in the final statements.
- (e) The Project had procured a tanker, 03 trucks and 20 other vehicles at a cost of Rs 87.9 million during the year under review. However, an allocation of only Rs 16.74 million had been made in the annual work plan of the project for that purpose.

## 6 Financial and Operating Review

### 6.1 Utilization of Funds

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The following observations are made.

- (a) Although detailed action plan had been prepared covering entire Project period by highlighting financial and physical targets in quarterly manner, due to lack of progress report based on the above plan there were no mechanisms introduced for identification of deviations and taking required remedial measures. Therefore, the above plan had not been utilized for effective control device for the Project activities.
- (b) According to the information made available, financial progress of the Project as at 31 December 2013 is given below.

	ADB LOAN	ADB GRANT	NTF Grant	GOSL	TOTAL
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	-			-	-
Agreed contribution (US\$ Mn)	99.78	23.22	2.00	38.33	163.33
Project expenditure up to 31 December 2013 (US \$Mn)	11.61	5.58	1.19	7.69	26.07
Utilization of funds as a Percentage	12	24	60	20	16

- (c) An additional allocation of US\$ 50 million equivalent to Rs. 5954 million had been made to implement 04 development activities in Northern Province in 2013 and US \$ 40 million out of that agreed to be financed by ADB. However, PIPES/V&M/19

contract valued at US \$1.380 million had only been awarded during year under review , thus indicated thatUS \$ 49.7 million representing 99 per cent, out of US \$50 million of allocation had unused idle at the year end.

- (d) Certain significant statistics relating to the financing and budgetary provision for the year under review, utilization of funds during the year under review and the cumulative utilization as at 31 December 2013 are shown below.

	Amount agreed to be provided in the Loan Agreement		Budgetary provision for the year 2013	Funds utilized during the year	Funds utilized up to 31December 2013
	US\$ (Mn)	Rs (Mn)	Rs (Mn)	Rs (Mn)	Rs (Mn)
ADB	125	14,531	1,435	1,298.9	2,402.7
GOSL	38.33	4,446	800	433.7	1,006.0
<b>Total</b>	<b><u>163.33</u></b>	<b><u>18,977</u></b>	<b><u>2235</u></b>	<b><u>1732.6</u></b>	<b><u>3,408.7*</u></b>

- \* These amounts differ from the amounts shown in paragraph 4.1 of this report due to exclusion of advances and accrued expenses.

According to above information relating to utilization of funds, it appears that progress of the Project was very much behind from the targets.

## 6.2 Physical Performance

The following observations are made.

- (a) The Project was scheduled to be completed by 30 June 2016. According to the progress reports presented by the Project, the overall physical and financial progress of the Project as at the end of the year under review was 47 per cent and 16 per cent respectively. However 62per cent of the Project period had been expired as at 31 December 2013.
- (b) It was a common feature that the delays in implementing project activities due to delay in project preparatory stage and application of tendering procedures.
- (c) The contract awarded to activities carry out under PIPES/C&P/18 Chillaw and Puttlam couldn't be implemented timely due to disputes arisen between the bidders. Subsequently the ADB had not grant the concurrence on selected bidder which caused to further delay.

(d) Contract No – PIPES/V/10  
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The activities carried out under water supply scheme in Vauniya had been delayed due to delays in supplying foreign material. However, according to the information made available, it was observed that the foreign material supplied was not tallied with the standard specification and therefore that material had been rejected.