

Water Sector Development Project II - 2015

The audit of financial statements of the Water Sector Development Project II for the year ended 31 December 2015 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 the Loan Agreement No.SL-P 93 dated 29 July 2008 entered into between the Democratic Socialist Republic of Sri Lanka and the Japan International Cooperation Agency along with the Section 4.03 of Article IV of the Subsidiary Loan Agreement No.SL-P 93 dated 16 December 2010 entered into between the National Water Supply and Drainage Board and the Democratic Socialist Republic of Sri Lanka.

1.1 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Water Sector Development Project II, then Ministry of Water Supply and Drainage, presently the Ministry of City Planning and Water Supply is the Executing Agency and the National Water Supply and Drainage Board is the Implementing Agency of the Project. The main objectives of the Project are to provide safe drinking water by expanding the water supply facilities in the Greater Colombo area and reducing Non-Revenue Water including the low income communities in the City of Colombo and thereby contribute to improve the living environment in the areas. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 10,846 million equivalent to Rs. 10,330 million and out of that Japan Yen 8,388 million representing 77.30 per cent equivalent to Rs. 7,989 million was agreed to be financed by the Japan International Cooperation Agency. The balance amount of Japan Yen 2,458 million representing 22.70 per cent equivalent to Rs.2,341 million was expected to be contributed by the Government of Sri Lanka. The Project commenced its activities in July 2008 and scheduled to be completed by December 2012. Subsequently, the period of the Project had been extended up to 31 May 2017.

1.2 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards 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.

1.3 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 includes 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 statement 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 Loan etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (e) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project,
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (g) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards,
- (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 Agreement had been complied with.

1.4 Basis for Qualified Audit Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

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, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Accounting Standards,

- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) 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 Agreement,
- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous audit report, and
- (e) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) Value Added Tax aggregating Rs. 741.49 million paid to the contractor had been set off against the contribution received from the Government of Sri Lanka instead of being shown under the work - in - progress. As a result, the value of work in-progress and contribution received from the Government of Sri Lanka had been understated by similar amounts.
- (b) According to the reports of the Department of External Resources, interest and commitment charges aggregating Rs. 295.59 million had been recovered by the Donor Agency as at 31 December 2015. However, this amount had not been taken in to the financial statements of the Project .

2.2.2 Un - reconciled balances

The value of work-in-progress amounting to Rs.9,560.40 million as at 31 December 2015 shown in the financial statements of the Project had not agreed with the corresponding value of work-in-progress amounting to Rs.10,577.40 million shown in the financial statements of the National Water Supply and Drainage Board for the year ended 31 December 2015. Further, the balance of the foreign loan amounting to Rs. 7,513.09 million shown in the financial statements of the Project had not been agreed with the balance of foreign loan amounting to Rs. 7,622.55 million shown in the financial statements of the National Water Supply and Drainage Board.

2.2.3 Non - compliances with laws, rules and regulations.

The following instances of non- compliances were observed in audit.

- (a) The Register of Fixed Assets of the Project had not been maintained in proper manner as enable to hand over the fixed assets procured by the Project to the Implementing Agency .
- (b) The Project had not been taken action to make provision for gratuity for the staff members who had completed service over 05 years in the Project, in accordance with the Gratuity Act, No.12 of 1983.

3. Financial and Physical Performance

3.1 Fund Utilization

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 2015 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
				during the year under review		as at 31 December 2015	
	JPY Million	Rs. Million	Rs. Million	JPY million	Rs. Million	JPY Million	Rs. Million
JICA	8,388	7,989	-	2,344	2,661	8,268	10,737
GOSL	2,458	2,341	472	209	236	1,465	1,849
Total	<u>10,846</u>	<u>10,330</u>	<u>472</u>	<u>2,553</u>	<u>2,897</u>	<u>9,733</u>	<u>12,586</u>

The following observations are made in this regard.

- (a) Eventhough the period of the Loan had been closed on 12 November 2015, the period of the Project had been extended up to 12 May 2017 due to delays in completion of the works under the Project. Therefore, action had been taken by the Project to transfer a sum of Rs.1,128.33 million to a dedicated bank accounts of a contractor, as special advance made to the contractor with bank guarantee to complete the balance works. However, unutilized advance amounting to Rs.1,096.93 million had remained in the dedicated accounts as at 31 December 2015.
- (b) It was observed that the Project had incurred commitment and interest charges amounting Rs. 57.49 million additionally as at 31 December 2015, due to delays in implementing of the activities of the Project.

3.2 Physical Progress

According to the progress reports of the Project, the overall physical progress of the activities of the Project had been reported as 98.50 per cent as at 31 December 2015. Further, the works under 15 contracts had only been completed as at 31 December 2015, out of the works under 21 contracts scheduled to be completed by the Project.

3.3 Matters in Contentious Nature

As mentioned in the Paragraph 3.1(a) of the report, the Project had taken action to transfer a sum of Rs.1,128.33 million to a dedicated Bank Savings Account of a contractor to complete the balance works of the Project. However, the concurrence of the Ministry of Finance had not been obtained for the above mentioned arrangement. In addition, the interest amounting Rs 6.64 million earned by the contractor during the year under review had not been transferred to the Project even as at 31 December 2015.

3.4 Issues in Financial Controls

The activities of the Project had not been subjected to audit of the Internal Audit Section of the National Water Supply and Drainage Board as required by the Financial Regulation 133 and the Circular No.05 of 26 July 2010 of the Department of Management Audit of the General Treasury.

3.5 Extraneous Transactions

The following observations are made.

- (a) It was observed that the water transmission cost amounting to Rs.24.06 million spent by the Project as at 31 December 2015 was not related to achieve the objectives of the Project.
- (b) The materials procured by the Project at a cost of Rs.84.71 million through contractors engaged in civil construction works had been transferred to Regional Offices of the National Water Supply and Drainage Board. Thus, it indicated that the materials had been procured by the Project without being assessed the real needs of the assets.