

Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 2276 -SRI) - 2014

The audit of financial statements of the Secondary Towns and Rural Community Based Water Supply and Sanitation Project for the year ended 31 December 2014 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 and the Loan Agreement No.2276 SRI dated on 06 June 2007 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Secondary Towns and Rural Community Based Water Supply and Sanitation Project, National Water Supply and Drainage Board under then Ministry of Water Supply and Drainage, presently Ministry of Urban Development, Water Supply and Drainage is the Principal Executing and Implementing Agency of the Project. The objectives of the Project are to provide safe water to 969,000 people and sanitation to 171,500 people in 05 urban areas and in the rural areas of North Central Province and increases the capacity of the Government of Sri Lanka to provide safe water by strengthening the water sector institutions. Initially the Asian Development Bank had allocated US\$ 60.29 million equivalent to Rs.5,803 million under the Loan No 1993 SRI – (SF) dated 18 August 2003 and due to severe price escalation since its original appraisal, the Asian Development Bank had approved a Supplementary Loan No 2276-SRI to achieve the above objectives. As per the Supplementary Loan Agreement, the initial estimated total cost of the Project is US\$ 63.24 million equivalent to Rs.6,889 million and out of that US\$ 39.81 million equivalent to Rs.4,336 million or 63 per cent was agreed to be financed by the Asian Development Bank and US\$ 23.43 million equivalent to Rs. 2,552 million or 37 per cent was agreed to finance by Government of Sri Lanka. As a result of cost overrun, estimated total amount financed by the Asian Development Bank had been increased up to US\$ 48.80 million equivalent to Rs.5,323 million and the Government of Sri Lanka contribution had also been increased up to US\$ 41.87 million equivalent to Rs.4,568 million. Activities of the Project were scheduled to be completed by 30 June 2010. Subsequently, the period of the Project had been extended up to 31 July 2014. However, the financial statements for the supplementary allocation of the Loan for the year ended 31 December 2014 had been presented for audit.

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 as necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

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 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 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, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project,

- (d) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (e) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles and
- (f) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report.

1.5 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 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purposes for which they were provided, and
- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

The balance of the Currency Fluctuation Reserve Account as at 31 December 2014 amounting to Rs.67,654 had inappropriately been shown in the financial statements under current liabilities.

2.2.2 Non - Compliance with Laws, Rules and Regulations

The following observations are made.

- (a) A monthly report on Value Added Tax (VAT) payments amounting to Rs.38 million made during the year under review had not been furnished to the Commissioner General of Inland Revenue with a copy to the Auditor General

in accordance with the Section 5.4.12 of Procurement Guideline, Section 21 of the VAT Act No. 14 of 2002 and Paragraph 5 of Public Finance Circular No 364 (3) of 30 September 2002.

- (b) According to Section 08 of the Public Contract Act, No.03 of 1987, the contractors who accepted contracts for Rs. 5 million or more should be registered under Registrar of Public Contract. Further, within 60 days after awarding of the tender, the tender agreement should be registered with the Registrar of Public Contract. This requirement had not been accomplished by the contractors who engaged with activities of the Project.
- (c) Transactions of the Project had not been subjected to the internal audit as required by the Management Audit Circular No. 05 of 26 July 2010.

2.2.3 Lack of Evidence for Audit

According to the records of the Project, 7,905 cubic meter of rock material had been excavated and a sum of Rs.57.8 million incurred thereon. However, no evidence had been received to audit to prove either usage for Project activities or sale of such rock materials.

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 2014 are shown below.

| Source | Amount agreed for financing in the Loan Agreement | | Allocation made in the Budget Estimate for the year under review | <u>Funds utilized</u> | | | |
|--------------|---|------------------------|--|------------------------------|----------------------|---------------------|------------------------|
| | US\$ million | Rs. million | | US\$ million | Rs. million | US\$ million | Rs. million |
| ADB | 48.80 | 5,323.00 | - | - | - | 48.80 | 5,490.94 |
| GOSL | 41.87 | 4,568.00 | 170.00 | 1.26 | 166.25 | 37.60 | 4,295.11 |
| Total | <u>90.67</u> | <u>9,891.00</u> | <u>170.00</u> | <u>1.26</u> | <u>166.25</u> | <u>86.40</u> | <u>9,786.05</u> |

3.2 Physical Progress

According to the information furnished, four contracts on pipe laying, construction of water treatment plants water towers and stormwater drainage improvements activities etc. in Hambantotta, Batticaloa and Muttur Districts were expected to be implemented at the inception of the Project at a cost of US\$ 63.24 million. However, the total estimated cost of 04 contracts had been revised as US\$ 90.66 million later on. However, all the contracts under the Project had been completed by 30 April 2013.

3.3 Contract Administration

The following observations are made.

- (a) The Project had settled the claims made by the contractor engaged in construction of head works, raw water transmission, treatment plant water towers and supply and laying of pipelines etc in Batticaloa District and delay charges amounting to Rs.11,336,247 had been paid thereon.
- (b) Eventhough the Project had paid US\$ 1,165,736 and Rs.4,293,757 to supply 1,720 cubic metres of GAC Filter Media on 23 June 2011, only 1,315.6 cubic metres had been supplied by the Contractor on 30 September 2014. Further, US\$ 364,825 and Rs.1,343,761 had been deducted thereon on 29 September 2014.

3.4 Matters in Contentious Nature

A sum of Rs.62 million payable to a contractor as at 31 December 2014 was expected to be settled, out of the contribution of Government of Sri Lanka and accounting adjustments had been made accordingly even though it was not confirmed by the General Treasury.