

## **Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 2276 -SRI) - 2013**

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The audit of financial statements of the Secondary Towns and Rural Community Based Water Supply 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 (GOSL) read in conjunction with Section 2.09 of Article II of the Project Agreement and the Loan Agreement No.2276 SRI dated on 14 December 2006 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank (ADB).

### **1.2.1 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, the National Water Supply and Drainage Board under the Ministry of Water Supply and Drainage is the Principal Executing and Implementing Agency of the Project. The Asian Development Bank has approved the Loan No 1993 SRI – (SF) amounting to US\$ 60.3 million on 18 August 2003. The objectives of the Project are to provide safe water to 969,000 people and sanitation to 171,500 people in five urban areas and in the rural areas of North Central Province and increase the capacity of the Government of Sri Lanka to provide safe water by strengthening the water sector institutions. Due to severe price escalation since its original appraisal, the Asian Development Bank had approved a Supplementary Loan ( Loan No- 2276-SRI ) to meet the construction and completion of Head Works,

Raw Water Transmission Main and Treatment Plant (40,000 m<sup>3</sup>/day) and design, build, supply and laying of treated water transmission main pipe lines (36km) and construction of seven elevated water towers supply and laying of distribution pipe lines (145km) and construction of elevated towers and construction and completion of storm water drainage improvement in Muttur Urban Area. According to the Supplementary Loan Agreement, the estimated total cost of Project is increased up to US\$ 70.5 million and out of that US\$ 46.5 million or 66 per cent was agreed to be financed by the Asian Development Bank and US\$ 24 million or 34 per cent was agreed to be financed by Government of Sri Lanka. As a result of the cost overrun, estimated total amount financed by the Asian Development Bank had been increased up to US\$ 48.79 million and the Government of Sri Lanka contribution had also increased up to US\$ 41.87 million. Activities of the Project were scheduled to be completed by 31 December 2009. Subsequently the period of the Project had been extended up to 30 June 2012. However, the activities of the Project had been continued up to 31 December 2013 with the financial provision made by Government of Sri Lanka.

### **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. 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**

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 to enable as wide 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 estimates 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 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 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.,
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreements,
- (d) Whether the funds, materials and equipment supplied under the Loan 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 satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (h) Whether financial covenants laid down in the Loan Agreements had been complied with.

### 3. 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 5 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the 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) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (d) the financial covenants laid down in the Loan 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.76,795,902 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 9,767,167,456. 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		Cumulative Expenditure as at 31 December 2013
	31 December		
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	2013	2012	
	Rs.	Rs.	Rs.
Civil Works	67,760,664	372,819,470	5,859,830,348
Equipment and Materials	9,035,238	146,935,500	3,748,751,922
Interest Charges	-	19,976,386	158,585,186
<b>Total</b>	<b><u>76,795,902</u></b>	<b><u>539,731,356</u></b>	<b><u>9,767,167,456</u></b>

#### 4.2 Imprest Fund Account

According to the financial statements and the information made available, the Imprest Fund Account had not been operated in the year 2013.

### 5. Audit Observations

The following observations are made.

- a) Although the work completion certificates for two contracts had been issued, the Bank Guarantees amounting to Rs. 5 million made by the National Water Supply and Drainage Board on behalf of the Road Development Authority for the reinstatement of roads had not been withdrawn by the Project even as at 31 July 2014.

- b) Although one per cent on contract payment should be deducted and remitted to Commissioner General of Inland Revenue as a levy of the Construction Industry Guarantee Fund, the Project had not complied with that requirement.
- c) Net foreign currency difference amounting to Rs.67,654 had inappropriately been shown under current liabilities in the financial statements.
- d) According to the cash flow statement, a sum of Rs. 43 million had been spent in 2013 to procure equipment and materials. However, according to the receipts and payment account it was shown as Rs. 66 million. Hence, the payment made to procure equipment and materials shown in the cash flow statement had been understated by Rs.23 million. Further, payments amounting to Rs.125 million made for civil works in 2013 had been shown in the receipts and payment account as Rs. 178 million. Hence, the payment for civil work shown in the cash flow statement had been understated by Rs.53 million.
- e) Transactions of the Project had not been subjected to an internal audit in terms of the Management Audit Circular No. 05 of 26 July 2010..
- f) According to the records, 7,910 cubic metres of rock had been excavated under two contracts and a sum of Rs. 58 million had been spent thereon. However, no documentary evidence in support of the usage or sale of the excavated rocks had not been furnished to audit.
- g) It was observed that the allocations amounting to Rs. 8.6 million made for staff training and procurement of furniture and equipments for administration building had been utilized for procurement of Backhoe Loader.

## **6. Financial and Operating Review**

### **6.1 Utilization of Funds**

The following observations are made.

- a) To ensure the achievement of Project objectives using allocated resources within schedule time period, a comprehensive detailed action plan highlighting financial and physical targets with fixing responsibilities in monthly, quarterly, biannually etc. covering the entire Project period should have been prepared. However, no such plan had been prepared and implemented by the Project.
- b) 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.

Source	Amount agreed to be provided		Budgetary provision for the year 2013	Funds utilized During the year	Funds utilized up to 31 December 2013	
	US\$ (Mn)	Rs (Mn)	Rs (Mn)	Rs (Mn)	US\$ (Mn)	Rs (Mn)
ADB	48.80	5,500.80	2.16	2.15	48.8	5,490.94
GOSL	41.87	4,720.10	245.94	175.67	36.8	4,066.71 *
<b>Total</b>	<b><u>90.67</u></b>	<b><u>10,220.90</u></b>	<b><u>248.1</u></b>	<b><u>177.82</u></b>	<b><u>85.6</u></b>	<b><u>9,557.65 *</u></b>

\* According to the Financial Statements the Government of Sri Lanka contribution amounted to Rs. 4,133.03 million and the difference amounted to Rs.66.32 million. Please refer paragraph 4.1 (a) of this report.

## 6.2 Physical Progress

The following observations are made.

- (a) According to the information furnished, four contracts for US\$ 63.24 million were expected to be implemented at the inception of the Project. However, estimated cost had been revised as US\$ 90.66 million in 2010 resulting in 43.3 per cent increase mainly due to delay in the implementation of the Project. Even though the contracts had been substantially completed as at 30 April 2012 the final bill in respect of one contract had not been submitted even by 31 July 2014. Hence, the total cost of the respective contract could not be ascertained in audit.
- (b). Two contracts namely, the Construction and Completion of Head Works, Raw Water Transmission Main and Treatment Plant (Plan, Design and Build ) (PA 1) and the Supply and Laying of Treated Water Transmission Pipe Lines and Construction of Elevated Water Towers(PC1), out of the contracts mentioned in the above paragraph, had been delayed by 19 months and 21 months respectively as compared with the due dates of completion. It was further observed that those two contracts had been handed over to the National Water Supply and Drainage Board and issued the substantive completion certificate on 20 October 2011 and on 30 April 2012 respectively. However, the final completion certificates had not been issued even at the end of May 2014.