

Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 2275 -SRI) - 2013

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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.2275 SRI dated on 06 June 2007 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank (ADB).

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, the National Water Supply and Drainage Board (NWSDB) under the Ministry of Water Supply and Drainage is the Principal Executing and Implementing Agency of the Project. The ADB has approved the Loan No.1993 SRI-(SF) amounting to US\$ 85.6 million including GOSL 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 increases the capacity of the GOSL to provide safe water by strengthening the water sector institutions. Due to unrealistic total cost estimation and price escalation since its original appraisal, the ADB had approved a Supplementary Loan (Loan No.-2275-SRI) from ADB's Ordinary Capital Resources (OCR) to meet Construction and Completion of Salinity Barrier Across Walawa River at Ambalantota and supply and laying of distribution pipes and construction of elevated water towers.

According to the supplementary Loan Agreement, the estimated total cost of the Project is US\$ 19.1 million and out of that US\$ 13.5 million or 70.6 per cent was agreed to be financed by ADB and US\$ 5.6 million or 29.4 per cent was agreed to be financed by Government of Sri Lanka (GOSL). As a result of cost overrun, estimated total cost of the Project had increased up to US\$ 21.5 million and the GOSL contribution had also increased up to US\$ 8 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.

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 an 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 examination also included such tests 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 etc,
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (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 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 Agreement,
- (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.

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,
- d) 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 Agreement,
- e) the financial covenants laid down in the Loan Agreement 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. 218,410,808 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 2,184,123,100. A summary of the expenditure for the year under review, expenditure for 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.
Civil Works	112,864,257	134,289,016	1,442,110,987
Equipments and Materials	105,545,551	178,777,855	690,436,598
Interest Chargers(Subsidiary)	-	11,064,422	51,575,515
Total	<u>218,409,808</u>	<u>324,131,293</u>	<u>2,184,123,100</u>

5. Audit Observation

5.1 Accounting Deficiencies

The following observations are made.

- a) Transactions of the Project had not been subjected to audit by the Internal Audit Section of the National Water Supply and Drainage Board as per the Management Audit Circular No. 05 of 26 July 2010.
- b) Although one per cent on contract payment should be deducted and sent to the Commissioner General of Inland Revenue as a levy of the Construction Industry Guaranteed Fund (CIGFL) the Project had not complied with that requirement.
- c) According to the cash flow statement, a sum of Rs.268 million had been spent in the year 2013 for civil works and equipments and materials However, the actual amount paid according to the receipts and payment account amounted to Rs.236 million. Hence, the payment for civil works equipments and materials and Advances shown in the cash flow statement had been overstated by Rs.32 million.

6. Financial and Operating Review

6.1 Utilization of Funds

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		Budgetary provision for the year 2013	Funds utilized during the year	Funds utilized up to 31 December 2013	
	to be provided					
	US\$ (Mn)	Rs (Mn)	Rs (Mn)	Rs (Mn)	US\$ (Mn)	Rs (Mn)
ADB	12.80	1,442.66	124.50	123.82	11.4	1,303.48
GOSL	8.00	902.30	157.32	112.37	7.0	833.18
Total	<u>20.80</u>	<u>2,344.96</u>	<u>281.82</u>	<u>236.19*</u>	<u>18.4</u>	<u>2,136.66*</u>

* The above mentioned figures differ from the figures shown in Paragraph 4.1 of this report, due to the effect of accrued expenses.

6.2 Physical Progress

The works under the two contract agreements of the Project had substantially been completed and handed over to the National Water Supply and Drainage Board as at 31 December 2013. Although the contract of construction, completion and commission of Gated Salinity Barrier across Walawe River at Ambalantota had been substantially completed and handed over to the National Water Supply and Drainage Board by incurring cost of Rs. 1,209,424,076, the thirty two defects highlighted in the taking over certificate issued on 25 November 2013 which should have been rectified within 3 months from the date of taking over the certificate had not been rectified even up to 31 July 2014.