

Eastern Province Water Supply Development Project (Rural Water Component) -2014

The audit of financial statements of the Eastern Province Water Supply Development Project (Rural Water Component) 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 4.08 (a) of Article III of the Loan Agreement No.SL-P 98 dated 26 March 2010 entered into between the Democratic Socialist Republic of Sri Lanka and Japan International Co-operation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Finance and Planning, presently the Ministry of Finance is the Executing Agency and the Eastern Provincial Council is the Implementing Agency of the Project. The objective of the Project is to provide safe drinking water by constructing and expanding water supply facilities in the Eastern Province, and thereby contribute to improve living standards and reduce the poverty in the area. As per Loan Agreement, the estimated total cost of the Project was Japan Yen 6,054 million and out of that Japan Yen 4,904 million was agreed to be financed by the Japan International Co-operation Agency. Further, Japan Yen 924 million had been allocated for the Rural Water Component of the Project and for that purpose, Japan Yen 764 million agreed to be financed by the Japan International Co-operation Agency. The Project commenced its activities on 26 March 2010 and scheduled to be completed by December 2013. Subsequently, the period of the Project was extended up to 31 July 2014. However, the financial statement 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 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.

1.4 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 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 identifications of the purchases made out of the Loan.
- (d) 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.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (f) Whether the funds, materials and equipments supplied under the Loan had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

- (j) Whether the financial covenants laid down in the Loan Agreement had been complied with.

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.
- (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 Agreement.
- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year 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 Deficiency

Commitment charges amounting to Rs 4.25 million and Interest charges amounting to Rs.10.89 million paid during the year under review related to National Component of the Project had been charged to the Rural Water Component.

2.2.2 Non-compliance with Laws, Rules and Regulations

The Construction Industry Guarantee Fund Levy amounting to Rs.4.21 million had been reimbursed from the proceeds of the Loan eventhough the local taxes and

duties are not eligible for financing, according to Section 1 of Schedule 2 of the Loan Agreement.

2.2.3 Issues related to the Statement of Expenditure Procedure

It was revealed in audit test checks that the Project Monitoring Unit had submitted Statements of Expenditure on estimated amount aggregating Rs.250.75 million for reimbursement purposes and out of that, a sum of Rs.183.35 million had been reimbursed by the Lending Agency during the year under review.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to financing, budgetary allocation for the year under review, utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed to be financed according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized		
	Japan Yen	Rs.		during the year under review	as at 31 December 2014	
	million	million	million	million	million	million
JICA	764.00	972.01	316.60	282.85	231.65	1,180.57
GOSL	160.00	203.56	110.92	100.77	-	230.72
Total	924.00	1,175.57	427.52	383.62	231.65	1,411.29

3.2 Physical Progress

The Project had implemented 24 civil construction works and pipe laying activities in Trincomalee, Ampara and Batticaloa districts during the period of the Project. According to the progress reports of the Project, 99 per cent of the works on such activities had been physically completed as at 31 July 2014.

3.3 Contract Administration

The following observations are made.

- (a) The contract awarded in 2012 for civil works and supplying and laying of pipes under Pulmoddai Water Supply Scheme at a cost of Rs.152.93 million had been completed and handed over to the National Water Supply and Drainage Board on 02 February 2015. Further, following observations are made.
 - (i) The physical inspection carried out by the auditors on 28 May 2014 had pointed out that the leakages at six locations at the base slab of the

water tank. Such defects had been rectified subsequently by the contractor through a sub- contractor. Eventhough the sub – contractor had offered a warranty for 10 year period, the Project had not taken action submit the original warranty certificates to the National Water Supply and Drainage Board up to 30 June 2015.

- (ii) The Project had taken action to lay U-PVC distribution pipes along Pulmoddai- Kokilai Road under Pulmoddai Water Supply Scheme without obtaining the concurrence of Road Development Authority. As a result, U-PVC pipes of 1100 metre in length laid at a cost of Rs. 914,375 was totally damaged within 01 month of the date of pipes laid, due to widening of the Road.
 - (iii) In addition, out of 02 intake wells constructed by the Project under Pulmoddai Water Supply Scheme for the purpose of pumping water to the water treatment system, 01 intake well constructed close to Yan Oya was not operated even as at 24 June 2015 due to lack of electricity supply.
- (b) The Project had implemented a water supply scheme at Padavisiripura and the following observations are made thereon.
- (i) Eventhough it was identified that the people living in the Divisional Secretariat Division of Padavisiripura was highly affected by Chronic Kidney Diseases, action had not been taken by the Project to provide water treatment facility for purifying purposes. It was observed at the physical site visits that untreated water directly supplied from the dug well was being distributed to the households. Eventhough the Project had spent Rs.149.45 million for this water supply scheme, beneficiaries of the area had to incur additional cost to buy drinkable water supplied by Padavisiripura Pradeshiya Shabha.
 - (ii) It was observed that a sum of Rs.1.10 million had been claimed by the contractor for the pipe laying activities of main distribution line of the water supply scheme of Padavisiripura which was carried out by the Project with community participation.
- (c) The Project had awarded a contract at an estimated cost of Rs.20.91million to construct 02 shallow well intakes, water towers and pump houses etc under the water supply scheme implemented at Karadiyanaru in Batticaloa District. It was observed that 01 shallow well intake was collapsed while the construction works were being taken place. Therefore, the Project had awarded another contract to install tube well for the collapsed shallow well at a cost of Rs.1.99 million. According to the design prepared for installation of pump of the tube well, the diameter of the rock hole should be 178mm. However, the diameter

of the rock hole before installation of pump was less than 150mm. As a result, pump purchased for this purpose could not be installed. Further, the diameter of the bore hole up to 12 metre in depth should be 225 mm. However, the diameter of the constructed bore hole was 178 mm. Retention money amounting to Rs.99,755 had been released to the contractor on 31 December 2014 eventhough the installation works of the of tube well was not completed as at that date.

- (d) The physical inspection carried out on 04 June 2015 at the Water Supply Schemes Karadiyanaru and Alankulam in Batticaloa district had revealed that the water treatment system of such water supply schemes had not been monitored by the Technical Officers. Further, the quality tastings had not been carried out to ensure for providing of safe drinking water to the general public. Further, the Inventory Registers had not been maintained properly by the Community Centres to ensure the physical existence of the assets of the Water Supply Schemes handed over by the Project.