

Ratmalana / Moratuwa and Ja- Ela / Ekala Wastewater Disposal Project - 2014

The audit of financial statements of the Ratmalana/ Moratuwa and Ja-Ela/ Ekala Wastewater Disposal 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 Article 11 of the Specific Agreement (Contribution No 71001436) dated 02 March 2006 entered into between the Government of Sri Lanka and the Swedish International Development Cooperation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Specific Agreement of the Project, 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 objective of the Project is to assure the management of pollution in the two areas of Ratmalana / Moratuwa and Ja-Ela /Ekala with appropriate collection of industrial and domestic wastewater treatment in central treatment plants with disposal of treated wastewater and sludge in such a way that it is not harmful to the environment or the people. The long term overall objectives of the Project are to contribute to improve health and living conditions for people in the area improved environmental conditions in sensitive eco-systems and establish a sustainable development of the industrial areas around Colombo through provision of sewerage networks and treatment facilities in Ratmalana /Moratuwa and Ja-Ela / Ekala areas. As per the Specific Agreement, the estimated total cost of the Project is US\$ 120.02 million equivalent to Rs. 12,135 million and out of that US\$ 91.92 million equivalent to Rs. 9,058 million or 74.6 per cent was agreed to be financed by the Swedish International Development Cooperation Agency as a Loan and US\$ 4.14 million equivalent to Rs. 474 million or 3.9 per cent as a Grant. The balance of US\$ 23.96 million equivalent to Rs. 2,603 million or 21.5 per cent was agreed to be financed by the Government of Sri Lanka. Subsequently, total cost of the Project was revised up to US\$ 148.91 million equivalent to Rs. 17,471 million and out of that US\$ 95.06 million equivalent to Rs. 11,315 million or 64.8 per cent was agreed to be financed by the Swedish International Development Cooperation Agency as a Loan and US\$ 8.99 million equivalent to Rs. 1,034 million or 5.9 per cent as a Grant. The balance of US\$ 44.86 million equivalent to Rs. 5,122 million or 29.3 per cent was agreed to be financed by the Government of Sri Lanka. The Project commenced its activities on 01 February 2008 and scheduled to be completed by 30 June 2013. Subsequently, the period of the Project had been extended up to 30 June 2016.

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 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.

1.4 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 and Grant, etc.
- (d) Whether the opening and closing balances and withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether the funds, materials and equipments supplied under the Loan and Grant 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 Specific 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 Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances and withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (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 Specific Agreement.
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Specific Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) Land and land administration cost amounting to Rs. 113.38 million had been shown under work-in-progress of the financial statements as at 31 December 2014 instead of shown as freehold lands. Further, a sum of Rs. 3.42 million spent for land and land administration purposes during the year under review had been shown under operating activities instead of shown as investing activities in the statement of cash flow.
- (b) The guarantee bonds valued at Rs.9.20 million placed at the Road Development Authority on laying of wastewater pipelines in Ratmalana / Moratuwa area had not

been brought to the account. Hence, the current assets shown in the financial statements had been under stated by the same amount.

- (c) Value Added Tax aggregating Rs. 1,424.42 million paid up to 31 December 2014 had been set off against the proceeds of government contribution instead shown under the work-in-progress. As a result, government contribution and the work-in-progress shown in the financial statements had been understated by similar amount.

2.2.2. Un-reconciled Balances

The following observations are made.

- (a) As per the information furnished by the Ministry of City Planning and Water Supply, total expenditure shown under this Project as at 31 December 2014 amounted to Rs. 438.70 million was not agreed with the total expenditure shown in the financial statements of the Project amounted to Rs. 659.45 million. The difference of Rs. 220.75 million had not been reconciled.
- (b) As per the information furnished by the National Water Supply and Drainage Board, the work-in-progress of the Project was Rs. 12,839.33 million as at 31 December 2014. However, corresponding amount had been shown in the financial statements of the Project as Rs. 12,856.84 million. The difference of Rs. 17.51 million had not been reconciled and adjusted in the accounts accordingly.

2.2.3 Non - Compliance with Laws, Rules and Regulations

The following observations are made.

- (a) According to the Circular No. MOFP/ERD/2007/2 of 07 August 2007 of the Ministry of Finance and Planning, the financial statements of the Project for the year ended 31 December 2014 required to be submitted to the Auditor General on or before 31 March 2015. However, financial statements for the year under review had been submitted only on 15 December 2015.
- (b) According to Section 08 of the Public Contract Act No. 03 of 1987, contractors who accepted contracts exceeding the value of Rs. 5 million should be registered under Register of Public Contract. Further, within 60 days after the awarding of the tender, the tender agreement should be registered with Register of Public Contract. However, those requirements had not been complied by the contractors who dealt with the Project.
- (c) The transaction of the Project had not been audited by the Internal Audit Section of the National Water Supply and Drainage Board, as per the Financial Regulation 134 (3) and Management Audit Circular No. 05 of 26 July 2010.
- (d) The Board of Survey on Property, Plant and Equipment of the Project valued at Rs. 142.84 million had not been carried out, according to the Financial Regulation No. 756.

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 / Grant Agreement				Allocation made in the Budget Estimate for the year under review	Funds Utilized			
	during the year under review		as at 31 December 2014						
	<u>Initial Allocation</u>		<u>Amended Allocation</u>						
	US\$ million	Rs. million	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
Loan	91.92	9,058	95.06	11,315	400.00	1.14	148.75	85.69	9,834.88
Grant	4.14	474	8.99	1,034	100.00	1.69	220.75	8.00	960.81
GOSL	23.96	2,603	44.86	5,122	306.13	2.22	289.95	27.44	3,573.85
	<u>120.02</u>	<u>12,135</u>	<u>148.91</u>	<u>17,471</u>	<u>806.13</u>	<u>5.05</u>	<u>659.45</u>	<u>121.13</u>	<u>14,369.54</u>

3.2 Physical Progress

According to the progress reports furnished by the Project, the overall physical and financial progress of the Project at the end of the year under review was remained as 91 per cent and 82.85 per cent respectively. The construction works of Ja-Ela / Ekala waste water treatment plant and pipe laying activities had been substantially completed as at 31 December 2012. Eventhough the construction works of Moratuwa / Ratmalana waste water treatment plant and pipe laying activities had shown a progress of 91.16 per cent as at 31 December 2014, the other subsidiary activities such as rider pipe laying, construction of manholes and pressure testing etc, had shown a slow progress of 0.38 per cent during the year 2014.

3.3 Contract Administration

The following observations are made.

- (a) It was observed that the contract awarded on wastewater disposal system of Ratmalana/Moratuwa awarded in 2008 had been terminated in 2013 by the Project as the contractor was bankrupt and failed to continue the contract activity. The following observations are made in this connection.
 - (i) The Project had not taken action to obtain confirmations on performance bond and guarantees on retention money submitted by the contractor. As a result, the Project had failed to encash the performance bond of US\$ 9.06

million and guarantees of US\$ 7.96 million made on retention money from a foreign Commercial Bank. Further, an additional sum of Rs. 3.55 million had been spent to obtain legal opinion from an international firm during the year under review. However, the Project had not taken action to commence legal proceeding against the contractor up to 30 April 2016.

- (ii) In addition the above, the Project had not taken action to recover the overpayment of US\$ 6.74 million made to the contractor. Further, a sum of Rs. 17.81 million had been claimed by the Sri Lanka Telecom and Ceylon Electricity Board on damages made to properties of the respective entities.
 - (iii) It was observed that the Project and National Water Supply and Drainage Board had spent a sum of Rs. 23.75 million to restore the condition of roads based on complaints made by the residents and road users who suffered on delays in completion of the construction works.
- (b) Eventhough the construction works of wastewater disposal management system of Ja-Ela / Ekala had been completed and handed over to the National Water supply and Drainage Board in 2012, the hydraulic capacity test to be carried out as required by the contract agreement at an estimated cost of US\$ 33,000 had not been carried out even up to 30 April 2016.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) As a practice, the computation of the remuneration for the staff of the Project is being done by the National Water Supply and Drainage Board and 20 per cent of overhead is being charged from the Project eventhough the Project had recruited adequate staff for its administration works. The overhead expenditure so paid by the Project to the National Water Supply and Drainage Board as at 31 December 2014 amounted to Rs. 253.27 million.
- (b) Eventhough the construction works of Moratuwa / Ratmalana wastewater treatment and disposal system was not completed, the Project had spent a sum of Rs. 1.82 million, out of the government contribution during the year under review for an opening ceremony.

3.5 Extraneous Transactions

A sum of Rs. 37.44 million spent by the Project for construction works of the wastewater treatment and disposal system for Madiwala Link Housing Scheme and design and building contract for the construction and completion of quarters of Soysapura for employees of the National Water supply and Drainage Board was not directly related to the objectives of the Project.

3.6 Unsettled Audit Issues Highlighted in the Previous Audit

The following observations made in the audit report of the previous year had been remained unsettled.

- (a) Seven motor vehicles procured by the Project at a cost of Rs. 28.23 million in 2012 had been shown in the financial statements as work-in-progress inappropriately.
- (b) As per the Article I of the Specific Agreement, the treated water and sludge should be disposed in such a way that is not harmful to the environment or the people in respect of the Ja-Ela / Ekala Waste Water Control Treatment Plant. However, no such system had been implemented even at the date of the audit in year 2016.

3.7 Issues on financial control

The following observations are made.

- (a) The value of 10 bank guarantees aggregating Rs. 20.82 million obtained from years 2009, 2010 and 2011 for road reinstatement works had not been released even as at 30 April 2016, eventhough that works had already completed and handed over to the relevant authorities.
- (b) The 05 refundable deposits aggregating Rs.12.98 million placed at the Road Development Authority in 2012 and 2013 for road reinstatement works had not been encash, eventhough the period of refundable deposits had been elapsed.