

## **Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 1993 -SRI) - 2014**

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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 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 dated 18 August 2003 and Section 28 of Schedule 6 of the Loan Agreement dated 18 August 2003 entered into between the National Water Supply and Drainage Board, 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 Project, then Ministry of Water Supply and Drainage, presently 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 objectives of the Project are to provide safe water to approximately 969,000 people and sanitation facilities for 32,572 families people living in the rural areas of Anuradhapura and Polonnaruwa Districts in the North Central Province and in the towns of Batticaloa, Hambantota, Muttur and Polonnaruwa. It will increase the financial and institutional sustainability of the National Water Supply and Drainage Board and the institutional capacity of the Provincial Councils, Pradeshiya Sabhas and Community Based Organizations. According to the Loan Agreement No. 1993 SRI – (SF) dated on 18 August 2003, the estimated initial total cost of the Project was US\$ 86.34 million equivalent to Rs.8,310.22 million and out of that US\$ 60.29 million equivalent to Rs.5,802.91 million or 70 per cent was agreed to be financed by the Asian Development Bank and US\$ 3.03 million equivalent to Rs.291.63 million or 4 per cent was expected to be contributed by the Community Based Organizations. Subsequently, the estimated total cost of the Project was increased up to US\$ 131.03 million equivalent to Rs.14,297 million and out of that US\$ 72.51 million equivalent to Rs.7,911 million or 55 per cent was agreed to be financed by the Asian Development Bank. Further, the Supplementary Loans of US\$ 61.59 million equivalent to Rs. 6,720 million under the Loan No.2276- SRI of Special Fund and Loan No. 2275- SRI of Ordinary Capital Resources of Asian Development Bank had been allocated for the Project. However, due to cost overrun for the completion of balance works as per the revised cost estimates, another additional two loans of US\$ 15 million equivalent to Rs. 1,637 million under the Loan No. 2757 -SRI and Loan No. 2758 had been provided by the Asian Development Bank. The Project commenced its activities on 21 November 2003 and scheduled to be completed by 31 March 2009. Subsequently, the period of the Project had been extended up to 30 September 2011. According to the information furnished by the Project, the Asian Development Bank had granted the approval to

utilize the full loan amount up to February 2013. However, the balance works of the Project had been carried out up to 31 December 2014, out of the contribution received from the 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 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 judgment, 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.
- (f) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (g) 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, 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 Receivables**

A sum of Rs. 2.7 million recoverable as at 31 December 2014 from a contractor, out of the electricity charges amounting to Rs. 4.7 million paid by the Project in 2010 on behalf of the contractor for testing of the Treatment Plant had not been brought to account.

## **2.2.2 Non - Compliance with Laws, Rules and Regulations**

The following observations are made.

- (a) A monthly report on payment of Value Added Tax (VAT) aggregating Rs. 41 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 the 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 the awarding of the tender, the agreement should be registered with Registrar of Public Contract. However, 09 contractors who dealt with the Project had not complied with the above requirements.

## **2.2.3 Lack of Documentary Evidence for Audit**

The following observations are made.

- (a) Good Received Notes, supplier invoices etc. which related to the recommended and mandatory spare parts supplied by the contractor under the contract of Construction and Completion of Head Works, Raw Water Transmission Main, Treatment Plant and Treated Water Transmission Main and Rehabilitation of Existing Water Treatment Plant valued at US\$ 80,946 and Rs. 802,610 had not made available for audit.
- (b) According to the records maintained by the Project, 3,143 cubic meter of rocks material had been excavated under contract of Supply and Laying of Distribution Pipes and Construction of Elevated Towers and a sum of Rs.11 million had been spent thereon. However, any evidence to confirm the usage or sale of such excavated rocks material was not available to audit.

## **3. Financial and Physical Performance**

### **3.1 Utilization of Funds**

Certain significant statistics relating to the financing of funds, 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 to be financed according to the Loan Agreements		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
				during the year under review		up to 31 December 2014	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	72.51	7,911.00	-	-	-	71.33	7,742.77
GOSL	58.52	6,385.00	200.00	1.50	199.04	57.34	6,776.05
<b>Total</b>	<b><u>131.03</u></b>	<b><u>14,296.00</u></b>	<b><u>200.00</u></b>	<b><u>1.50</u></b>	<b><u>199.04</u></b>	<b><u>128.67</u></b>	<b><u>14,518.82</u></b>

### 3.2 Physical Progress

The following observations are made.

- (a) To ensure the achievement of Project objectives using allocated resources within scheduled time period, there should be a comprehensive detailed action plan highlighting financial and physical targets with fixing responsibilities in monthly, quarterly, biannually etc. covering entire Project period. Such plans had not been prepared and implemented by the Project.
- (b) Eventhough the Project had expected to provide safe water to approximately 969,000 people living in the rural areas of North Central Province and in the towns of Batticaloa, Hambantota, Muttur and Polonnaruwa, statistics which related to water connections provided by the Project was not readily available for audit.
- (c) The Project had allocated a sum of Rs.135 million to provide sanitation facilities to 32,572 families in the North Central Province and in the towns of Batticaloa, Hambantota, Muttur and Polonnaruwa under the Rural Water Supply and Sanitation Programme. However, original targets had been revised significantly from time to time so as to match with the actual performance. It was observed that sanitation facilities had been provided only for 22,511 families by incurring Rs. 126 million as at 31 December 2014.

### 3.3 Contract Administration

According to the information received, all the construction works of the Project carried out at Hambantota, Batticaloa, Muttur and Polonnaruwa under 09 contracts had been completed as at 31 January 2012. The following observations are made thereon.

- (a) The financial charges amounting to US\$ 38,023 and Rs. 229,167 on delays in settling of interim payments to the contractor for supplying and laying of Distribution Pipes and Construction of Elevated Towers had been paid by the Project during the year under review.
- (b) The ownership for 26 plots of land in Batticaloa, Hambantota, Polonnaruwa and Muttur acquired for the construction of water supply schemes had not been transferred to the National Water Supply and Drainage Board even as at 31 December 2014.
- (c) However, 03 construction works carried out in Batticaloa and Muttur had substantially been completed by incurring Rs.1,888 million and handed over to the National Water Supply and Drainage Board as at 30 September 2011 with the substantive completion certificates, the final completion certificates had not been issued even as at 31 December 2014.

### **3.4 Matters in Contentious Nature**

A sum of Rs. 229.5 million payable to three contractors as at 31 December 2014 was expected to be settled out of the contribution receivable from the Government and accounting adjustments had been made accordingly even though it was not confirmed by the General Treasury.

### **3.5 Issues related to the Financial Controls**

Transactions of the Project during the year under review had not been subjected to audit of Internal Audit Division of the National Water Supply and Drainage Board as required by the Management Audit Circular No. 05 of 26 July 2010.