

## **Kandy City Wastewater Management Project - 2014**

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The audit of financial statements of the Kandy City Wastewater Management 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 the Loan Agreement No. SLP 99 dated on 26 March 2010 entered in to between Democratic Socialist Republic of Sri Lanka and then Japan Bank of International Cooperation presently known as Japan International Cooperation Agency.

### **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 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 objectives of the Project is to improve the living environment and water quality of Mahaweli River through better sanitation facilities by constructing a proper system for collection, treatment, and disposal of wastewater in Kandy City, including rehabilitation of sanitation facilities in densely populated areas, and thereby enhance the standard of living, health, and well-being of the people in the area. The estimated total cost of the Project is Japan Yen 17,278 million equivalent to Rs.21,982 million and out of that JapanYen 14,087 million equivalent to Rs.17,922 million was agreed to be provided by the Japan International Cooperation Agency. The Project commenced its activities on 20 September 2011 and scheduled to be completed by September 2017.

### **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 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 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 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 etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipment supplied under the Loan 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 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 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 Presentation of Financial Statements**

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 had only been submitted on 11 February 2016.

### **2.2.2 Accounting Deficiencies**

The following observations are made.

- (a) Retention Money amounting to Rs. 28.2 million deducted from the contractor during the year under review had not been brought to the financial statements.
- (b) Liabilities amounting Rs. 1.4 million to be settled by other donor funded project called Kandy City Wastewater Disposal Project which was closed in September 2011, had been shown under the current liabilities of this Project erroneously.

### **2.2.3 Un-reconciled Balance**

As per the information furnished by then Ministry of Water Supply and Drainage and the Line Ministry, proceeds of foreign funds amounting to Rs. 746 million had been utilized in 2014 to implement the Project activities. However, the costs incurred, out of the proceeds of the foreign sources during the year under review was shown in the financial statements of the Project as Rs. 770.6 million.

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

The following instance of non-compliances were observed in audit.

- (a) As a practice, the monthly reports on payments of Value Added Taxes had not been furnished to the Commissioner General of Inland Revenue with a copy to the Auditor General as required by the paragraph 5.4.12 of the Government

Procurement Guideline, Section 21 of the Value Added Tax Act, No. 14 of 2002 and Paragraph 5 of Public Finance Circular No. 364 (3) of 30 September 2002. The total Value Added Taxes paid to the contractor during the year under review amounted to Rs. 11.2 million.

- (b) The Project should deduct Construction Industry Guarantee Fund Levy of 01 per cent on contract payments as specified in the Section 03 of Finance Act No. 05 of 2005 as amended by the Acts No. 13 of 2007 and No. 18 of 2009 to be recovered and remitted to the Commissioner General of Inland Revenue. However, action had not been taken to deduct and remit the levy on the total contract payments of Rs. 9.3 million as at 31 December 2014.
- (c) According to the Section 8 of the Public Contract Act, No. 03 of 1987, contractors who accepted contracts valued at Rs. 5 million or more should be registered under Registrar of Public Contract. Further, the contract agreements should be registered with Registrar of Public Contract within 60 days after the awarding of the contractor. It was observed that 02 contractors who entered in to contract agreements with the Project had not complied with the above mentioned requirements.

### 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 Agreement |               | Allocation made in the Budget Estimate for the year under review | Funds utilized               |               |                        |                 |
|--------|---|---------------|--|------------------------------|---------------|------------------------|-----------------|
|        |   |               |  | during the year under review |               | as at 31 December 2014 |                 |
|        | JPY million                                       | Rs. million   | Rs. million  | JPY million                  | Rs. million   | JPY million            | Rs. million     |
| JICA   | 14,087  | 17,922        | 1,000  | 607.90                       | 770.60        | 957.20                 | 1,237.95        |
| GOSL   | 3,191   | 4,060         | 300  | 60.55                        | 76.30         | 179.30                 | 231.37          |
|        | <u>17,278</u>                                     | <u>21,982</u> | <u>1,300</u>   | <u>668.45</u>                | <u>846.90</u> | <u>1,136.50</u>        | <u>1,469.32</u> |

The following observations are made in this regard.

- (a) A sum of Japan Yen 957.20 million equivalent to Rs 1,237.95 million representing 6.8 per cent, out of the total allocation of Japan Yen 14,087 million equivalent to Rs 17,922 million had only been utilized as at 31 December 2014, after lapse of 03 years and 03 months from the date of commencement of the activities of the Project. In addition, out of the allocation amounting to Rs. 1,300 million made in the Budget Estimate for the year 2014, only Rs. 1,136.5 million equivalents to 65.1 per cent had been utilized at the end of the year under review.

- (b) As mentioned in the audit report for the previous year, the Project had not prepared comprehensive plan to achieve objectives of the Project using allocated resources and as a result, a slow progress was shown on physical activities as well as utilization of funds of the Project. Further, the commitment charges are being paid regularly due to slow progress on utilization of funds. Therefore, a sum of Rs. 73.4 million had been paid by the Project as at 31 December 2015 on funds underutilized.

### **3.2 Physical Progress**

According to the progress reports prepared by the Project, the overall physical and financial progress at the end of the year under review was 9.4 per cent and 9.02 per cent respectively. The civil construction works of the Project had been divided in to 04 major packages and the total estimated cost for civil works amounted to Japan Yen 12,636 million and Rs. 16,077 million. Out of that, the civil construction works of a package only had been commenced during the year under review.

### **3.3 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 the salary cost is charged from the Project as overhead expenditure even though the Project had recruited adequate staff for its administration works. This matter was highlighted in my report for the previous year and no action had been taken to avoid such additional expenditure of Rs 6.8 million paid during the year under review by the Project to the National Water Supply and Drainage Board.
- (b) It was observed that the compensation on a land acquired for construction of a pump house in Kandy City by the project called Kandy City Wastewater Disposal Project which was closed in 2011 had been paid by this Project, with delays of 06 years and 09 months. As a result, interest of Rs 3.5 million had also been paid thereon. In addition, other balances payable aggregating Rs 3.5 million had also been transferred from the above mentioned Project without adequate details and shown under the current liabilities in the Statement of Financial Position of the Project as at 31 December 2014.

### **3.4 Issues on Financial Control**

The following observations are made

- (a) The Board of Surveys on property, plant and equipment of the Project procured at Rs. 4.35 million had not been carried out during the year under review, as required by the Financial Regulation No.756. Further, the Fixed Assets Register required to be maintained as per the Treasury Circular No. 842 of 19 December 1978 had not been maintained.
- (b) The transactions 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.