

Dry Zone Urban Water and Sanitation Project - 2015

The audit of financial statements of the Dry Zone Urban Water and Sanitation Project for the year ended 31 December 2015 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 No. 2477 SRI (SF) of 29 June 2009, Grant No 0129/0130 SRI (SF) of 29 June 2009 and 2977-SRI(SF) of 13 February 2013 entered into between 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 and Grant Agreements of the Project, then Ministry of Water Supply and Drainage, presently the Ministry of City Planning and Water Supply is the Executing Agency and National Water Supply and Drainage Board is the Implementing Agency of the Project. The objectives of the Project are to improve physical well-being of the urban population in Sri Lanka's northern and north western dry zone, which include, Mannar and Vavunia Districts in the Northern Province and Puttalam District and Chillaw in the North Western Province. As per the Loan and Grant Agreements, the revised total cost of the Project was US\$ 163.33 million equivalent to Rs.19,165 million and out of that US\$ 99.78 million equivalent to Rs. 11,809 million or 61.09 per cent was agreed to be provided as a Loan and US\$ 23.22 million equivalent to Rs.2,649 million or 14.22 per cent was agreed to be provided as a Grant by the Asian Development Bank. The Netherland Trust Fund (NTF) has also agreed through Asian Development Bank to make a Grant of US\$ 2 million equivalent to Rs.228 million or 1.22 per cent from for the Water Financing Partnership Facility and remaining balance of US \$ 38.33 million equivalent to Rs.4,479 million or 23.47 per cent was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 13 November 2009 and scheduled to be completed by 30 June 2013. However, the completion date 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 statement 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 and Grant, etc.
- (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 and Grant Agreements.
- (e) Whether the opening and closing balances and withdrawals from and replenishments to the Special Dollar Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (f) Whether the withdrawals under the Loan and Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements.
- (g) Whether the funds, materials and equipment supplied under the Loan and Grant had been utilized for the purposes of the Project.
- (h) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.

- (i) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (j) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (k) Whether the financial covenants laid down in the Loan and Grant Agreements had been complied with.

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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 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 and Grant Agreements,
- (d) the opening and closing balances and withdrawals from and replenishments to the Special Dollar Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (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 Loan and Grant Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1.1 Accounting Deficiencies

The following observations are made.

- (a) The provision for compensation amounting to Rs. 5.46 million to be paid to the farmers on loss of paddy harvest had not been made in the financial statement as at 31 December 2015.
- (b) Motor vehicles valued at Rs. 64.88 million had been categorized and shown under office equipment, due to a classification error.
- (c) The interest amounting to Rs. 68.50 million charged by the General Treasury under the subsidiary loan agreement entered into with the National Water Supply and Drainage Board had been shown under work-in-progress. The interest charges amounting to Rs. 49.79 million recovered up to 31 December 2015 by the Asian Development Bank had also not been brought to account.

2.2.2 Non - Compliance with Laws, Rules and Regulations

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

- (a) 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 tender agreement should be registered with Registrar of Public Contract within 60 days after the awarding of the tender. It was observed that 32 contractors who entered in to contract agreements with the Project had not complied with the above mentioned requirements.
- (b) The monthly reports on payment of Value Added Tax had not been submitted by the Project to the Commissioner General of Inland Revenue with a copy to the Auditor General in accordance with the paragraph No. 5.4.12 of the Government 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. Total Value Added Taxes paid up to 31 December 2015 amounted to Rs. 130.27 million.

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 2015 are shown below.

Source	Amount agreed for financing in the Loan and Grant Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilization			
	US \$ million	Rs. million		During the year 2015		Up to 31 December 2015	
	US \$ million	Rs. million	Rs. million	US \$ million	Rs. million	US \$ million	Rs. million
ADB- Loan							
2477	59.78	6,820	} 4,351	7.51	1,052	32.74	4,331
2977	40.00	4,989		11.82	1,655	18.62	2,533
ADB - Grant							
129	23.22	2,649	} 620	2.74	384	13.07	1,682
130	2.00	228		0.20	28	1.65	206
GOSL	38.33	4,479	-	5.12	717	17.78	2,226
Total	163.33	19,165	4,971	27.39	3,836	83.86	10,978

The initial allocation of US\$ 113.33 million made for the Project had been increased subsequently upto US\$ 163.33 million by the Lending Agency due to cost estimations made, based on unrealistic rates. However, slow progress on execution of the activities of the Project and funds utilization were reported by the Project continuously. It was observed that US\$ 83.86 million only had been utilized, out of the revised allocation even after lapse of 2 ½ years of the revisions made.

3.2 Physical Progress

The Project had implemented several water supply and sanitation activities in the Northern and North Western Provinces in order to improve physical well-being of the urban population in such areas and scheduled to be completed by 30 June 2016. However, according to the information received, the overall physical progress of the Project as at the end of the year under

review had remained at 76 per cent only. Further, although the detailed action plan had been prepared covering entire Project period by highlighting financial and physical targets in quarterly manner, periodical progress reports had not been prepared in line with the action plan as enable to identify the deviations and remedial measures taken thereon. Therefore, the action plan had not been utilized as an effective control device for proper implementation of the activities of the Project.

3.3 Contract Administration

The following observations are made.

- (a) The National Water Supply and Drainage Board had signed a Memorandum of Understanding in 2014 with the Assistant Commissioner of Department of Agrarian Development in Vaunia and District Secretary of Vaunia for renovation of 03 tanks and revamping of lands in Pathiyakulam and Katkulam for paddy cultivation at an estimated cost of Rs. 66.65 million. The following observations are made in this connection.
 - (i) The National Water Supply and Drainage Board had directly entered into the above mentioned Memorandum of Understanding with the Assistant Commissioner of the Department of Agrarian Development in Vaunia without obtaining the concurrence of the Department of Agrarian Development.
 - (ii) According to the information received, the contract to revamp a part of the land was awarded to the Department of Agrarian Development in May 2014 at an estimated cost of Rs. 4.61 million and out of that, a sum of Rs. 3.22 million had been released. However, the works to be completed by September 2014 had not been completed even up to March 2016. The present Assistant Commissioner of the Department of Agrarian Development Department had subsequently informed that the respective works cannot be completed, as the funds remitted by the Project were misused by the former Assistant Commissioner of the Department of Agrarian Development in Vaunia.
 - (iii) Due to delays in completion of the above works, the compensation amounting to Rs. 9.91 million had to be paid additionally, out of the contribution of the Government of Sri Lanka to the farmers on loss of paddy harvests in 2014 and 2015.
- (b) The contract for the Surface Water Development in Vaunia had been awarded in 2013 to a joint venture at an estimated cost of Rs. 956.82 million. The following observations are made on this contract.
 - (i) According to the Project Administration Manual, the works related to detailed designs, drawings, specifications, bill of quantities, cost estimates, tender documents and associated contract documents for procurement of equipment and civil works should be prepared under the supervision the Department of Irrigation. However, the

Consultant of the Project had completed all the design works related to the construction at Peru Aru tank, without obtaining approvals from the Department of Irrigation.

- (ii) It was observed that a contract at a cost of Rs. 13.27 million had been awarded for clearing and development of other infrastructure facilities in resettlement areas in Peru Aru and an addition payment of Rs 2.81 million had also been made under a variation order. Further, the costs on resettlement activities required to be met from the contribution of the Government of Sri Lanka had been incurred out of the proceeds of the Loan.
- (c) The contract value of Rs. 64.30 million for the construction of 03 storied office building for Regional Support Center in Vaunia awarded in 2010 had been completed and handed over on 24 January 2013. However, the final payments of the construction works was not settled even as at 31 December 2015 due to disputes arising between the contractor and Project.
- (d) The water transmission and distribution system in Mannar and Vaunia districts awarded in May 2013 had shown a slow progress of 66 per cent as at 31 December 2015. Further, the defects of the pipes laid on construction of water transmission and distribution system had been identified in September 2014 and directed the contractor to replace the pipes with inferior quality. However, the contractor had not taken action to replace the pipes even as at 31 May 2016.
- (e) It was observed that 02 contracts for development of ground water sources in Mannar awarded in 2013 at a cost of Rs. 38.85 million had shown a slow progress of 49 per cent as at 31 March 2016. Further, the contracts for surface water resources development in Chillaw and Puttlam awarded in 2014 at a cost of Rs. 610 million and the construction of water treatment plants at Chillaw and Puttlam awarded in 2014 at an estimated cost of Rs. 3.81 million were also shown slow progress of 47 per cent each up to 31 March 2016.
- (f) The activities under 04 contracts representing 16.5 per cent of the work of overall Project Implementation Plan had shown progress ranging of 8 per cent to 82 per cent as at 31 December 2015 eventhough such contracts were required to be completed in 2014. In addition, the physical progress of the activities of other 10 contracts representing 27 per cent of the works of the overall Project Implementation Plan had remained in range of 15 per cent to 88 per cent as at 31 December 2015.

3.4 Funds utilized outside the Purposes of the Project

Remuneration amounting to Rs.2.49 million of 03 employees of the National Water Supply and Drainage Board who were not involved in Project activities had been paid by the Project, out of the contribution of the Government of Sri Lanka.

3.5 Unsettled Audit Issues Highlighted in the Previous Audit

The following observations are made.

- (a) Expenses amounting to Rs.7.8 million incurred during the year 2008 out of the proceed of contribution of Government of Sri Lanka could not be satisfactorily vouched in audit due to non-availability of vouchers and relevant supporting documents. Even though this position was reiterated in my previous audit reports, such evidence were not furnished even as at 31 December 2015.
- (b) It was observed that the proceed of contribution of Government of Sri Lanka amounting to Rs.12.21 million had been utilized for procurement of construction equipment, materials and office equipment, during the year 2009 to 2013 without being utilized the allocation of US\$ 57 million made thereto in the Loan and Grant Agreements.

3.6 Issues on Financial Controls

The following observations are made

- (a) The Project Monitoring Unit had not taken action to maintain a proper coordination with the Implementing Agency and as a result, the value of civil work-in-progress amounted to Rs. 10,135.79 million as per the information furnished by the National Water Supply and Drainage Board was not agreed with value of civil work-in-progress of Rs. 10,180.19 million shown in the financial statements of the Project as at 31 December 2015 and action had not been taken to reconcile the difference of Rs. 44.40 million.
- (b) According to the Financial Regulation 134 (3) and Management Audit Circular No 05 of 26 July 2010, the activities of the Project had not been audited by the Internal Audit Section of the National Water Supply and Drainage Board.

3.7 Extraneous Activities

The Project had taken action to procure a computer package for accounting purposes at a cost of Rs. 628,932 after lapse of 5 years of the commencement of the activities of the Project. However, several defects observed at the implementation of the system had not been rectified even as at 31 May 2016 for effective use for the intended purposes.