

Water Supply and Sanitation Improvement Project - 2016

The audit of financial statements of the Water Supply and Sanitation Improvement Project for the first accounting year ended 31 December 2016 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 II (C) (3) of the Financing Agreement No. 5685 – LK dated 06 November 2015 and Article 4.09 (b) of the General Conditions of the Credits and Grants of the International Development Association dated 31 July 2010 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement of the Project, the Ministry of City Planning and Water Supply is the Executing and Implementing Agency of the Project. The objectives of the Project are to increase the access to piped water services and improved sanitation in selected districts and to strengthen the capacity of associated institutions. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 183.9 million equivalent to Rs.24,458.70 million and out of that, US\$ 165 million equivalent to Rs.21,945 million was agreed to be provided by International Development Association. The Project commenced its activities on 07 December 2015 and scheduled to be completed by 31 December 2020.

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 identification of the purchases made out of the Credit, etc.
- (d) Whether the initial advances, withdrawals from and the 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether the withdrawals under the Credit had been made in accordance with the specifications laid down in the Financing Agreement.
- (f) Whether the funds, materials and equipment supplied under the Credit 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, and
- (i) Whether the financial covenants laid down in the Financing Agreement 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, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the initial advances, withdrawals from and the 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 2016 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 Financing Agreement, and
- (e) the financial covenants laid down in the Financing Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Presentation of Financial Statements

Eventhough the activities of the Project had been initiated in 2015, the financial statements for the year ended 31 December 2015 had not been prepared and submitted for audit. However, the corresponding figures as at 31 December 2015 had been shown in the financial statements of the Project for the year under review.

2.2.2 Accounting Deficiency

Interest on Loan balances amounting to Rs.14.19 million paid by the Government of Sri Lanka had been accounted under the foreign loan instead of being shown under the contribution received from the Government of Sri Lanka. As a result, the Loan balance shown in the financial statements for the year under review had been overstated by similar amount.

2.2.3 Non-compliance with Laws, Rules and Regulations

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

- (a) It was observed that advances aggregating Rs.1.20 million made in 06 instances had been settled with delays from 01 to 04 months from the dates of completion of respective works eventhough such advances required to be settled immediately after the completion of the works, according to the Financial Regulation 371.
- (b) Annual Board of Survey on property, plant and equipment and inventory items procured by the Project had not been carried out for the year under review, in terms of the Financial Regulation 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 utilization of funds during the year under review and up to 31 December 2016 are shown below.

| Source | Amount agreed for financing in the Financing Agreement | | Allocation made in the Budget Estimate for the year under review | Funds utilized | | | |
|------------------------|--|-------------------------|--|----------------------|------------------------|------------------------|------------------------|
| | US\$ million | Rs. million | | during the year 2016 | | as at 31 December 2016 | |
| | US\$ million | Rs. million | Rs. million | US\$ million | Rs. million | US\$ million | Rs. million |
| IDA | 165.00 | 21,945.00 | 2,200.00 | 9.58 | 1,381.44 | 9.58 | 1,381.44 |
| GOSL | 5.00 | 665.00 | 57.17 | 0.43 | 58.06 | 0.48 | 64.90 |
| Community Contribution | 13.90 | 1,848.70 | - | - | - | - | - |
| | <u>183.90</u> | <u>24,458.70</u> | <u>2,257.17</u> | <u>10.01</u> | <u>1,439.50</u> | <u>10.06</u> | <u>1,446.34</u> |

According to the above information, the allocations amounting to Rs.2,200 million had been made in the Budget Estimate for the year under review and out of that only Rs.1,381.44 million had been utilized at the end of the year under review. Further, it was expected to achieve 9.60 per cent of financial progress during the first year of operations of the Project and 2.16 per cent of financial progress only had been achieved as at 31 December 2016. A comprehensive plan for the entire period to achieve the objectives of the Project within scheduled time period had not been prepared by the Project and as a result, the risks on timely utilization of funds allocated by the Financing Agreement for intended purposes cannot be ruled out in audit.

3.2 Physical Progress

According to the Project Documents, the activities of the Projects are scheduled to be implemented under 04 Components namely, rehabilitation and expansion of urban, rural and estate water supply and sanitation schemes, strengthening of the capacity of Department of National Community Water Supply, building of sector capacity through training and water quality mapping and Project management and administration. It was observed that the civil construction works in Badulla, Ratnapura, Kegalle districts under the Component of rehabilitation and expansion of urban, rural and estate water supply and sanitation schemes scheduled to be commenced during the year under review as per the Action Plan had not been commenced even at the end of the year under review, due to difficulties faced by the Project to acquire plots of lands suitable for civil construction works.

3.3 Contract Administration

The following observations are made.

- (a) Eventhough an Action Plan had been prepared by the Project for the year under review, the information on sanitation programs such as Divisional Secretariat areas in which the sanitation programs expected to be implemented, number of beneficiaries and time frame of implementation etc were not included therein. Therefore, the sanitation programs implemented during the year under review in Kilinochchi, Badulla and Mullaithivu districts, as mentioned in the Annual Performance Report could not be identified and compared with the Action Plan.

- (b) It was observed that a sum of Rs.2.41 million had been paid to a private Company in June 2016 to conduct soil investigation activities for water supply schemes expected to be implemented in Badulla and Kegalle districts and the respective reports had not been completed and submitted even as at 30 June 2017. As a result, the respective plots of lands could not be acquired by the Project.
- (c) The Project had taken action to procure a building in Nugegoda on rent basis for 05 years at a monthly rent of Rs.370,000. It was observed that the land of 10.76 perches was consisted appurtenant to the building, eventhough 40 perches of land required to be obtained as per Section 1.1.3 of the Schedule of Requirement.

3.4 Matters in Contentious Nature

It was observed that the Project had deployed 62 employees from an outside company, contrary to the Circular No. 1/2016 of 24 March 2016 of the Department of Management Services. A sum of Rs.7.72 million had been spent by the Project during the year under review for their salaries and other allowances.