

Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 2758 -SRI) - 2014

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 (a) of the Project Agreement and the Loan Agreement No.2758 SRI dated on 22 July 2011 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 Agreement of the Project, then Ministry of Water Supply and Drainage, presently the Ministry of Urban Development, Water Supply and Drainage is the Executing Agency and the National Water Supply and Drainage Board (NWSDB) is the Implementing Agency of the Project. The objectives of the Project are to provide safe water to 52,000 people in Muthur urban area of Eastern Province and increase the capacity to provide safe water by strengthening the water sector institutions. As per the cost estimate, the estimated total cost of the Project is US \$ 17.87 million equivalent to Rs.1,942 million and out of that, US\$ 13.3 million equivalent to Rs.1,446 million or 74 per cent was agreed to be financed by Asian Development Bank and US\$ 4.57 million equivalent to Rs. 497 million or 26 per cent was agreed to be financed by Government of Sri Lanka. Activities of the Project were initially scheduled to be completed by 30 June 2014 and subsequently, it had been extended up to 31 July 2015.

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 financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (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 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 Accounting Deficiencies

The following observations are made.

- (a) Property, plant and equipment procured by the Project up to 31 December 2014 at a cost of Rs. 1.3 million had been charged to increment operational cost instead of being accounted under fixed asset and provided depreciation thereon.

- (b) Expenses aggregating Rs. 6.5 million incurred during the year under review for other projects implemented by the National Water Supply and Drainage Board had been treated as the cost of this Project.

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 for financing according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized during year 2014	Funds utilized up to 31 December 2014	
	US \$ million	Rs. million	Rs. million	Rs. million	US \$ million	Rs. million
ADB	13.30	1,445.71	494.53	388.78	9.89	1,258.81
GOSL	4.57	496.76	69.57	88.73	3.25	376.36
Total	<u>17.87</u>	<u>1,942.47</u>	<u>564.10</u>	<u>477.51</u>	<u>13.14</u>	<u>1,635.17</u>

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. However, such a plan had not been prepared and implemented by the Project.

3.2 **Physical Progress**

The construction of head works, raw water transmission and treatment plant at Muttur had substantially been completed only on 28 November 2014 with delays over 11 months from the original date scheduled to be completed. However, reason for the delay was not explained for audit.

3.3 **Matters in Contentious Nature**

The following observations are made.

- a) As a practice, the computation of the remuneration of the Project staff is being done by the National Water Supply and Drainage Board and 20 per cent of the salary expenditure is being recovered from the Project as overhead charges even though the Project had recruited adequate staff for its administration works. The

overhead charges so paid by the Project to the National Water Supply and Drainage Board for the year under review amounted Rs. 2.8 million.

- b) Sums of Rs. 6.2 million and Rs. 4.9 million payable to a contractor and National Water Supply and Drainage Board as at 31 December 2014 was expected to be settled out of grants receivable from the Government and accounting dustmens had been made accordingly even though it was not confirmed by the General Treasury.

3.4 Idle and Underutilized Assets

The following observations are made.

- a) The contracts on supplying and laying of treated water pumps for main distribution pipeline (10.5 Km) and construction of two elevated water treatment plants had been completed by the Project at a cost of Rs.1,162,504,731 on 30 September 2011 after a delay in 2 years and remained idle even up to 31 December 2014 due to delays in completion of the related works under other contracts such as raw water transmission treatment plant and treated water pump which scheduled to be completed parallel to the respective contract.
- b) It was observed that the cash balance ranging from Rs. 7.2 million to Rs. 18.4 million had remained in the Bank Current Account of the Project throughout the year under review. Thus indicated that the proceeds of the Loan had remained idle without utilizing for the intended purposes, effectively.

4. Issues on Financial Controls

Transactions of the Project had not been subjected to the internal audit as required by the Circular No. 05 of 26 July 2010 of the Department of Management Services.