

Eastern Province Water Supply Development Project (Rural Water Component) - 2013

The audit of financial statements of the Eastern Province Water Supply Development Project for the year ended 31 December 2013 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 4.08 (a) of Article III of the Loan Agreement No.SL-P98 dated 26 March 2010 entered into between the Government of the Democratic Socialist Republic of Sri Lanka (GOSL) and Japan International Cooperation Agency (JICA).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Eastern Province Water Supply Development Project, the Eastern Provincial Council is the Implementing Agency of the Rural Water Component of the Project and the Ministry of Finance and Planning is the Executing Agency of the Project. The objective of the Project is to provide safe drinking water by constructing and expanding water supply facilities in the Eastern Province, and thereby contribute to improve living standards and reducing poverty in the area. According to the Loan Agreement, the estimated total cost of the Project is Japanese Yen.6,054 million. Out of this, Japanese Yen.4,904 million was to be financed by the JICA and the rest of the cost is to be financed by the Government of Sri Lanka. However, Japanese Yen.924 million only had been allocated for this Component and out of this; Japanese Yen.764 million is to be financed by the JICA and the rest of the cost is to be financed by the GOSL. The Project commenced its activities on 26 March 2010 and was scheduled to be completed by December 2013. Subsequently project period was extended up to 31 July 2014.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

2. Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore,

believe that my audit provides a reasonable basis for my opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records 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 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 asset and liabilities arising from the operations of the Project, the identification of the purchases made out of the Loan, etc.,
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (d) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project,
- (e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles,
- (g) Whether the opening and closing balances, withdrawals from and the replenishments to the Special Yen Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (h) 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,
- (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.

3. Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, and except for the effects of the adjustments arising from the matters referred to in paragraph 5 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances, withdrawals from and replenishments to the Special Yen Account during the year ended 31 December 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka 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 Loan Agreement,
- (e) 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 agreement had been complied with

4. Financial Statements

4.1 Financial Performance

According to the financial statements and information made available for audit, the expenditure of the Project for the year ended 31 December 2013 amounted to Rs. 488,715,310 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 1,027,670,755. The expenditure for the year under review, expenditure for the preceding year and the cumulative expenditure as at 31 December 2013 are summarized below.

Components	Expenditure		Cumulative Expenditure as at 31 December 2013
	for the year ended 31 December 2013	2012	
	Rs.	Rs.	Rs.
Civil Works	399,623,857	334,710,045	734,333,902
Consultancy Services	35,068,943	38,203,167	137,877,649
Motor Vehicles	-	-	6,384,000
Administrative Cost	21,843,705	17,197,370	55,653,990
Tax	32,178,805	34,359,379	74,290,849
Commitment Charges	-	7,156,048	14,952,848
Interest	-	4,091,808	4,177,517
Total	<u>488,715,310</u>	<u>435,717,817</u>	<u>1,027,670,755</u>

4.2 Special Yen Account

According to the financial statements and information made available, the operations of the Special Yen Account during the year under review and the balance available in that account as at 31 December 2013 are shown below.

	JPY	Rs.
Balance as at 01 January 2013	65,375,658	96,749,436
Add :		
Replenishments	244,102,654	322,472,734
	309,478,312	419,222,170
Less :		
Withdrawals	303,575,200	400,999,993
Foreign Exchange Loss	-	10,867,490
Balance as at 31 December 2013	<u>5,903,112</u>	<u>7,354,687</u>

5. Audit Observations

5.1.1 Accounting Deficiencies

A sum of Rs. 39,729,469 deducted as retention money from the bills submitted for works completed by the contractors had not been brought to account. As a result, the total value of civil works had been understated by that amount.

6. Financial and Physical Performance

6.1 Utilization of Funds

Certain significant statistics relating to financing of funds for budgetary provision for the year under review, utilization of funds during the year under review and cumulative expenditure as at 31 December 2013 are shown below.

Source	Amount agreed to be financed		Allocation made in the Annual Budget - 2013	Amount utilized during the year under review	Amount utilized as at 31 December 2013
	JPY.	Rs.	Rs.	Rs.	Rs.
JICA	764,000,000	972,010,178	493,500,000	434,692,800	878,595,551
GOSL	<u>160,000,000</u>	<u>203,562,340</u>	<u>91,200,000</u>	<u>54,022,510</u>	<u>149,075,204</u>
Total	<u>924,000,000</u>	<u>1,175,572,518</u>	<u>584,700,000</u>	<u>488,715,310</u>	<u>1,027,670,755</u>

6.2 Physical Performance

6.2.1 Contract Administration

The following observations are made.

(a) Supplying and Laying of Pipes

The Project had entered into an agreement with the contractor on 21 March 2012 to supply and lay pipes with associated civil works at Kokkadicholai and Porathivupattu in the Batticaloa District at cost of Rs. 34,481,034. The following observations are made in this connection.

- (i) According to the contract agreement, the works should have been completed within 165 days from the date of contract agreement. However, the contractor had completed only 80 per cent of the works even after elapse of 593 days. Therefore, the Project had terminated the contract with effect from 26 January 2014. It was observed that technical and financial capacities of contractor had not been evaluated with the required capacity at the initial stages. However, the performance bond valued at Rs. 1,724,052 had not been released.
- (ii) Although balance work had been awarded to a new contractor for Rs.7,747,809 the detailed work plans and cost estimates had not been prepared.

(b) Construction of Civil Works

The Project had entered into an agreement with the contractor on 10 May 2012 for Construction of Civil Works such as water towers, dug wells, pump houses and office buildings at Kokkadicholai and Porathivupattu in the Batticaloa District at a cost of Rs. 27,000,015. The following observations are made in this connection.

- (i) The Project had awarded the contract to the contractor without properly evaluating the past experience and the financial capacity of the contractor in civil works and the contractor had completed only 50 per cent of the works even after elapse of 458 days. Subsequently, the Project had terminated the contract due to poor performance of the contractor after the payment of mobilization advance amounting of Rs. 5,400,000 and interim payments amounting to Rs. 9,181,117.
- (ii) The balance works had been completed by awarding contracts to two other contractors for Rs. 26,562,708 and Rs. 11,384,676 respectively. Accordingly, the Project had spent an additional sum of Rs. 20,128,661 to complete the work.
- (iii) Action had not been taken to recover the mobilization advance amounting Rs. 2,854,253 to be recovered from the respective security bonds.

6.2.2 Construction of 450 Cubic Metre Reinforced Concrete Water Tower

A contract had been awarded to construct a reinforced concrete water tower at Pulmoddai Town in Trincomalee at a cost of Rs. 25,203,192. The following observations are made in this connection.

- (a) According to the contract agreement, the construction of water tower should have been completed within 330 days by February 2013. However, the construction work had not been completed even up to the date of audit inspection on 28 May 2014.
- (b) It was reported that there were water leaks at six places at the base slab of the water tower. However, the Consultant had not reported the reasons for such leaks, thus, indicating that the works had not been properly supervised and monitored by the Consultant.
- (c) It was further observed that the water leaks were rectified by the contractor by awarding sub-contract to another private company. The possibility of water leaks arising in other places of the water tower in future cannot be ruled out.