

Water Sector Development Project II - 2014

The audit of financial statements of the Water Sector Development Project II 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 Loan Agreement No.SL-P 93 dated 29 July 2008 entered into between the Democratic Socialist Republic of Sri Lanka and the Japan International Cooperation Agency along with Section 4.03 of Article IV of the Subsidiary Loan Agreement No.SL-P 93 dated 16 December 2010 entered into between the National Water Supply and Drainage Board and the Democratic Socialist Republic of Sri Lanka.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Water Sector Development Project II, then Ministry of Water Supply and Drainage, presently the Ministry of City Planning and Water Supply and Drainage is the Executing Agency and the National Water Supply and Drainage Board is the Implementing Agency of the Project. The main objectives of the Project are to provide safe drinking water by expanding the water supply facilities in southern part of the Greater Colombo area and reducing of Non-Revenue Water in Zone IV area in Colombo City and thereby contribute to improving living environment in the areas. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 10,846 million equivalent to Rs. 10,330 million and out of that Japan Yen 8,388 million or 77.3 per cent equivalent to Rs. 7,989 million was agreed to be financed by the Japan International Cooperation Agency. The balance amount of Japan Yen 2,458 million or 22.7 per cent equivalent to Rs. 2,341 million was expected to be contributed by the Government of Sri Lanka. The Project commenced its activities in July 2008 and scheduled to be completed by December 2012. Subsequently, the period of the Project had been extended up to 31 May 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 Sri Lanka Accounting Standards 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 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 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 Sri Lanka Accounting Standards.
- (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 Sri Lanka Accounting Standards,

- (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 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 the 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 for the year ended 31 December 2014 are required to be submitted to the Auditor General on or before 31 March 2015. However, the financial statements of the Project had been submitted only on 21 December 2016.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a) Commitment and interest charges amounting to Rs. 211.93 million paid by the Department of External Resources on behalf of the Project had not been brought to the financial statements of the Project.
- (b) Stocks procured by the National Water Supply and Drainage Board at a cost of Rs.17.27 million remained at the site office at Ambathale had been accounted as the properties of the Project.
- (c) Provision for gratuity for the staff members who had completed 5 year service of the Project had not been made in the financial statements.
- (d) A sum of Rs. 4.16 million spent for land acquisition purposes had been treated as work-in-progress, instead of being capitalized under Land and Land Development.

2.2.3 Un - reconciled balances

The work-in progress valued at Rs. 8,618.17 million at the end of the year under review shown in the financial statements of the Project was not agreed with the corresponding value of work-in progress amounted to Rs. 8,647.50 million shown in the records of the National Water Supply and Drainage Board.

3. Financial and Physical Performance

3.1 Funds Utilization

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	8,388	7,989	1,500	1,499	1,831	5,924	8,076
GOSL	2,458	2,341	295	258	298	1,256	1,613
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Total	<u>10,846</u>	<u>10,330</u>	<u>1,795</u>	<u>1,757</u>	<u>2,129</u>	<u>7,180</u>	<u>9,689</u>

3.2 Physical Performances

It was observed that the activities of the Project were rescheduled and completion period of the Project had been extended up 31 May 2017. According to the progress summary prepared by the Project, the contracts of the Project had been awarded under 19 packages and out of the contracts under 11 packages had been completed. Further, the slow progress of 37 per cent of the works under the rehabilitation and improvement of distribution system in Slave Island and Hultsdorf areas were reported. Further, the laying of pipes in unserved and extended areas of Kesbewa East/ West and construction works of office buildings for the offices of Area Engineer at Piliyandala and Kubuka had shown the physical progress of 64 per cent at the end of the year under review.

3.3 Contract Administration

The following observations are made.

- a) It was observed that, out of 84,039 metres of pipe laying activities scheduled to be carried out under the Contract Package – 09, the pipe laying works of 12,802 metres had not been completed. Further, 9,388 metres of additional pipe laying works had been carried out at Panadura and Kiriberiya areas which were not in the originally estimated pipe laying areas, on the request of outside parties who were not originally recognized beneficiaries.
- b) A sum of Rs. 108.15 million had been spent as additional cost of preliminaries and price escalation for 04 contracts due to delays in commencement of the works by the Project. In addition, a sum of Rs. 55.79 million had been spent by the Project as the additional cost on preliminary works and price escalations on the contracts for rehabilitation of distribution pipeline in Colombo Southern area, due to delays in implementation of activities by the contractor. However, action had not been taken to recover any liquidation damages from the contractor up 31 December 2014.

3.4 Matters in Contentious Nature

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 being charged from the Project as overhead expenditure, even though the Project possessed adequate staff for its administration works. The overhead expenditure so paid by the Project to the National Water Supply and Drainage Board amounted to Rs. 54.30 million as at 31 December 2014.

3.5 Issues on Financial Control

The following observations are made.

- a) Refundable deposits amounting to Rs. 1.00 million had been made by the Project for the purpose of buildings obtained for the use of Regional Office of the National Water Supply and Drainage Board at Horana on lease basis for 10 years. In addition, goods procured at a cost of Rs. 88.17 million by the Project had been allowed to use of Operational and Maintenance Division of the National Water Supply and Drainage Board.
- b) A sum of Rs. 5 million had been spent to improve sanitary facilities for the families living in Divisional Secretariat areas of Kesbewa and Homagama and shown as work-in-progress of the Project for the year under review.
- c) It was observed that the estimated cost of construction works of elevated water tower at Welmilla in Kindelpitiya amounted to Rs. 394.46 million had been increased up to Rs. 499.37 million, due to variations of the scope of the works. Out of that, the additional works valued at Rs. 71.91 million included therein were not directly related to the works scheduled to be implemented by the Project.
- d) It was observed that a sum of Rs. 32.64 million incurred as the transmission cost of Diyagama Sport Complex was not directly related to achieve the objective of the Project.

3.6 Issues on Financial Control

The following observations are made.

- a) The activities of the Project were not subjected to audit of the Internal Audit Division of the National Water Supply and Drainage Board as required by the Financial Regulation 133 and Management Audit Circular No. 05 of 26 July 2010.
- b) Properties and equipment procured by the Project at the cost of Rs. 47.15 million and shown in the financial statements of the Project had not been physically verified in terms of Financial Regulations 756.