

## **Dry Zone Urban Water and Sanitation Project (Loan No.2477-SRI/2977-SRI, Grant No.0129/130 SRI) -2014**

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The audit of financial statements of the Dry Zone Urban Water 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 II of the Project Agreement No. 2477 SRI (SF), Grant No 0129/0130 SRI (SF) dated 29 June 2009 and 2977-SRI (SF) dated 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 the Ministry of Water Supply and Drainage, presently the Ministry of Urban Development and Water Supply and Drainage, 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 north western dry zone, which include, Mannar and Vavuniya 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 by the Asian Development Bank as a Loan and US\$ 23.22 million equivalent to Rs.2,649 million or 14.22 per cent was agreed to be provided by Asian Development Bank as a Grant. The Asian Development Bank has also agreed to make a Grant of US\$ 2 million equivalent to Rs.228 million or 1.22 per cent from the Netherland Trust Fund (NTF) 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 originally. Subsequently, the total cost of the Project had been increased by US\$ 50 million on 18 December 2012 due to increase in input requirements for civil works and equipment and increase of taxes and duties estimated during the detailed designing of that additional cost, US\$ 40 million equivalent to Rs.4,988 million had been agreed to be financed by the Asian Development Bank and the balance of US\$ 10 million equivalent to Rs.1,247 million was agreed to be provided by the Government of Sri Lanka . The completion date of the Project had also 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 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 judgement, 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 withdrawals under the Loan and Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements.
- (f) Whether the funds, materials and equipments supplied under the Loan and Grant 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.
- (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 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 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 and Grant Agreements,
- (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 and Grant Agreements had been complied with.

## **2.2 Comments on Financial Statements**

### **2.2.1 Accounting Deficiencies**

The following observations are made.

- (a) The amount shown in the cash flow statement as cash received from the Government had been understated by Rs.26,817,487.
- (b) A sum of Rs.33,083,958 recovered by the ADB from the Loan as finance charges had not been brought to the financial statements.
- (c) Provision for Employee's Gratuity had not been brought to the financial statements for the year under review.

### **2.2.2 Non - Compliance with Laws, Rules and Regulations**

According to Section 08 of the Public Contract Act No. 03 of 1987, contractors who accepted contracts to the value not less than Rs. 5 million should register under Register of Public Contract. Further, within 60 days after the awarding of the tender, the tender agreement should be registered with Register of Public Contract. However, that requirement had not been complied with by the contractor who deals with the Project.

### **2.2.3 Fund utilized outside the Project Purposes**

Two employees work to the National Water Supply and Drainage Board had been remunerated by the Project and the total cost incurred up to 31 December 2014 on those employers was Rs.2,085,636.

### **2.2.4 Unsettled Audit Issues Highlighted in the Previous Audit**

The following observations are made.

- (a) Expenses incurred from GOSL funds during the year 2008 amounting to Rs.7.8 million 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, they were not furnished for the year under review as well.
- (b) The GOSL funds amounting to Rs.12,213,794 had been utilized for procurement of construction equipments, materials and office equipments, during the year 2009

to 2013 without being utilized a sum of US\$ 57 million allocated in the Loan and Grant agreements therefor.

### 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 2014 are shown below.

Source	Amount agreed for financing in the Loan/Grant Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilization			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
ADB-Loan							
2477	59.78	6,820	} 2,345	13.87	1,803	25.23	3281
2977	40.00	4,989		6.52	848	6.80	888
<b>Sub Total</b>	<b>99.78</b>	<b>11,809</b>		<b>20.39</b>	<b>2,651</b>	<b>32.03</b>	<b>4,169</b>
ADB Grant							
129	23.22	2,649	} 650	4.70	613	10.33	1,343
130	2.00	228		0.26	34	1.45	189
<b>Sub Total</b>	<b>25.22</b>	<b>2,877</b>		<b>4.96</b>	<b>647</b>	<b>11.78</b>	<b>1,532</b>
GOSL-Sub Total	38.33	4,479	680	5.00	650	12.66	1,656
<b>Grand Total</b>	<b>163.33</b>	<b>19,165</b>	<b>3,675</b>	<b>30.35</b>	<b>3,948</b>	<b>56.47</b>	<b>7,357</b>

The following observations are made in this regard.

- (a) The total estimated cost of the Project to complete the expected targets as at 30 June 2013 was US\$ 113.33 million. However, due to poor performance in execution of the activities and improper cost estimation, it had to be revised as US\$ 163.33 million increasing the initial total cost by 44 per cent to achieve the same targets.

- (b) Although a sum of Rs.6,236 million had been allocated to implement four development activities in Northern Province and North Western Province, the contract valued at Rs.1,105 million (WTP/C&P/04B) could not be awarded due to delay in completion of the contract of WTP/C&P/04A and therefore, Completion of the contract bearing No.WTP/C&P/04B is within the project period in doubt to the audit.

### 3.2 Physical Progress

The following observations are made.

- (a) Although 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 that plan enabling to identify the deviations and taking required remedial measures. Therefore, it was not observed that the above plan had been utilized for as an effective control device of implementation of the Project activities.
- (b) The Project is scheduled to be completed by 30 June 2016. According to the progress reports furnished to audit, the overall physical and financial progress of the Project as at the end of the year under review had been 63 per cent and 35 per cent respectively. However, 78 per cent of the project period had been over as at 31 December 2014.

### 3.3 Sanitation Programme

The details of the physical progress of sanitation programme at the end of the year under review are given below.

District/ Divisional Secretariat	Target (Nos)	Achievement as at 31 December 2014 (Nos)	Per cent	Cost incurred as per the Financial Statements Rs.
Chilaw	500	335	67	8,015,429
Puttalm	500	390	78	9,287,050
Mannar	330	297	87	6,711,250
Vauniya	500	199	35	3,389,750
<b>Grand Total</b>	<b>1,830</b>	<b>1,221</b>	<b>64</b>	<b>27,403,479</b>

According to the Project Administration Manual (PAM), it had been planned to provide sanitation facilities for 1,830 families. But, the actual facilities provided as at 31 December 2014 was 1,221 that is 66 per cent of the target. The financial progress could not be evaluated due to not furnishing the required information such as grant amount allocated for sanitation programme and its yearly breakup etc. However, the cost incurred for providing 1,221 sanitation facilities as at 31 December 2014 was Rs.27,403,479 According to the

above analysis, Vauniya District Secretariat area shown a low progress as against the other areas.

### **3.4 Contract Administration**

The physical progress of the main contract of Head work, New Treatment Plant and Raw Water Intake (contract No WIP/C&P/04A), which should have been carried out parallel to the work completed two contracts namely Supply and Laying HDPE and PVC Pipes Specials & Fittings, and Vales for Transmission Main Distribution System in Chilaw Water Supply Scheme Stages-I (contract No.PIPES/C/8A and the date of completion was 06 June 2014 ) and stage-II (contract No.PIPES/S/8B and the date of completion was 22 September 2014) as at 31 December 2014 was three per cent.

Due to delay in completion of the main contract, the completed two other projects could not be tested before elapse their defect liability Period. It was further observed that the progress of the main contract as at 30 June 2015 was only 16 per cent.