

Secondary Towns and Rural Community Based Water Supply and Sanitation Project (Loan No 2757 -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 (GOSL) read in conjunction with Section 2.09 of Article (a) of the Loan Agreement dated 22 July 2011 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

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 areas of Eastern Province and increase the capacity of the Government of Sri Lanka to provide safe water by strengthening the water sector institutions. The total cost of the Project is US\$ 5.5 million equivalent to Rs. 624.9 million and out of that US\$ 4.3 million equivalent to Rs.485.9 million or 78 per cent was agreed to be financed by Asian Development Bank and US\$ 1.2 million equivalent to Rs.139 million or 22 per cent was agreed to be financed by the Government of Sri Lanka. Activities of the Project were initially scheduled to be completed by 30 June 2014 and subsequently, the period of the Project 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.

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 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 Non – Compliances with Laws, Rules and Regulations

The following observations are made.

- (a) A monthly reports on payment of Value Added Tax amounting Rs. 55.8 million made during the year under review had not been sent to the Commissioner General of Inland Revenue with a copy to the Auditor General according to the Paragraph 5 of Public Finance Circular No 364 (3) of 30 September 2002.
- (b) According to Section 08 of the Public Contract Act, No.03 of 1987, the contractors who accepted contracts for Rs.5 million or more should be registered under the Registrar of Public Contract. Further, the tender agreement should be registered with the Registrar of Public Contract within 60 days after the awarding of the tender. This requirement had not been accomplished by the contractors who engaged with activities of the Project.

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 Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized during the year	Funds utilized up to 31 December 2014	
	US \$ million	Rs. million	Rs. million	Rs. million	US \$ million	Rs. million
ADB	4.30	485.94	93.47	73.48	3.88	472.71
GOSL	1.20	139.00	10.00	8.60	1.26	167.32
Total	<u>5.50</u>	<u>624.94</u>	<u>103.47</u>	<u>82.08</u>	<u>5.14</u>	<u>640.03</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. Such plan had not been prepared and implemented by the Project.

3.2 Physical Progress

The main purpose of this Project was to facilitate the needs of procurements of material for the construction of head works, raw water transmission and treatment plant at Muttur. The activities of procurement and construction of head works, raw water transmission and treatment plant etc, had substantially been completed only on 28 November 2014 with delays over 11 months from the original date scheduled to be completed.

3.3 Contract Administration

The following observations are made.

- (a) Allocation amounting to Rs.3.6 million made in the Bill of Quantities of the contract for construction and completion of head works, raw water transmission and treatment plant to procure two tractors and trailers had been used to procure two trucks at a cost of Rs. 4.2 million without an approval of the Procurement Committee.
- (b) An overpayment of Rs.600,000 had been made to a contractor due to erroneous calculation of a variation order valued Rs. 4.4 million

- (c) The consultancy contract entered into with a foreign firm on 23 June 2004 had been expired, before implementation of the construction activities of the Project. Further, a new Memorandum of Understanding had been signed with a Local Consultant on 20 May 2013 and fees amounting Rs. 8 million had been paid thereon during the year under review, out of the allocations made for the provisional payments included in the Bill of Quantities of the procurement contract. Further an overhead charge amounting Rs.2 million had also been paid to the contractor thereon.

- (d) Although the total payment of Rs. 23.6 million had been made to the contractor engaged for procurement of spare parts for contract of construction and completion of head works, raw water transmission and treatment plant, spare parts valued at Rs. 5.8 million had only been procured as at 30 April 2015.

3.4 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.

3.5 Matters in Contentious Nature

A sum of Rs.6.2 million payable to the contractor as at 31 December 2014 was expected to be settled out of grants receivable from the Government and accounting adjustments had been made accordingly, even though it was not confirmed by the General Treasury.