

Greater Kandy Water Supply Project -Phase I, Stage II - 2014

The audit of financial statements of the Greater Kandy Water Supply Project -Phase I, Stage 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 90 dated 28 March 2007 entered into between the Democratic Socialist Republic of Sri Lanka and then Japan Bank for International Corporation, presently known as Japan International Cooperation Agency along with Section 4.03 of Article IV of the Subsidiary Loan Agreement No.SL-P 90 dated 03 September 2008 entered into between the National Water Supply and Drainage Board and Democratic Socialist Republic of Sri Lanka.

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 City Planning and Water Supply is the Executing Agency and the National Water Supply and Drainage Board is the Implementing Agency of the Project. The objective of the Project is to improve the water supply service of the Greater Kandy and suburb areas. As per the Project cost estimate, the estimated total cost of the Project amounted to Japan Yen 4,664 million equivalent to Rs. 4,164 million. Subsequently, the cost estimate had been revised up to Japan Yen 5,497 million equivalent to Rs.7,146 million due to additional works and price fluctuations. Out of that JapanYen 4,634 million equivalent to Rs.6,024 million was agreed to be provided by the Japan International Cooperation Agency and the balance sum of Japan Yen 863 million equivalent to Rs.1,122 million was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 30 March 2007 and scheduled to be completed by 30 September 2012. Subsequently, the period of the Project had been extended up to 20 June 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 Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement.
- (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 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) Compensation on land acquisition amounting to Rs.11.7 million payable as at 31 December 2014 had not been brought to accounts.
- (b) Advances amounting to Rs.10 million made by the Project for land acquisition for other project called Kandy-Pathadumbara Water Supply Project had been treated as the advances made by this Project.

2.2.2 Un-reconciled Balances

As per the information furnished by the National Water Supply and Drainage Board, the value of work done on the activities of the Project was remained at Rs. 5,319.94 million as at 31 December 2014. However, as per the financial statements of the Project, it was shown as Rs. 6,410.54 million. The difference of Rs. 1,090.60 million had not been reconciled.

2.2.3 Non - Compliance with Laws, Rules and Regulations

The following instances of non-compliances are observed in audit.

- (a) 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 register under Registrar of Public Contract. Further, within 60 days after awarding of the tender, the tender agreement should be registered with the Registrar of Public Contract. This requirement had not been complied with by the contractors who dealt with the Project.

- (b) Interest amounting to Rs. 28.28 million charged by the Lending Agency under the Section 2 Article II of the Loan Agreement had been shown in the financial statements as a payable balance of interest under the Subsidiary Loan Agreement.

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 under review		as at 31 December 2014	
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	4,634	6,024	588.59	442	541.14	3,972.32	5,310.84
GOSL	863	1,122	60.00	49	60.00	841.84	1,040.94
	<u>5,497</u>	<u>7,146</u>	<u>648.59</u>	<u>491</u>	<u>601.14</u>	<u>4,814.16</u>	<u>6,351.78</u>

3.2 Physical Progress

According to the progress reports prepared by the Project, the activities of the Project including construction of service reservoirs, pump houses, laying/ improvements of transmission lines had been substantially completed as at 31 December 2014. However, the ownership of the respective land for water treatment plant, reservoir, water tank and office building etc, had not been transferred to the National Water Supply and Drainage Board even as at 31 December 2015.

3.3 Extraneous Expenses

It was revealed in audit that the general administration and other indirect expenses aggregating Rs. 47.20 million which were not eligible to claim as per Schedule 2 of the Loan Agreement had been claimed to settle the bills submitted by the contractor.

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 charged from the Project as overhead expenditure even though the Project had recruited adequate staff for its administration works. The overhead expenditure so paid by the Project to the National Water Supply and Drainage Board for the year under review was Rs.8.6 million.

3.5 Issues on Financial Controls

The following observations are made.

- (a) The property, plant and equipment shown in the financial statements amounting to Rs.1.1 million had not been physically verified during the year under review, as per Financial Regulation 756. Further, a Fixed Assets Register had not been maintained.
- (b) Transactions of the Project had not been subjected to the internal audit of the National Water Supply and Drainage Board, as required by the Circular No. 05 of 26 July 2010 of the Department of Management Audit.