

Monaragala, Buttala Integrated Water Supply Project - 2016

The audit of financial statements of the Monaragala, Buttala Integrated Water Supply Project for the year ended 31 December 2016 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 the Credit Agreement dated 16 June 2014 entered into between the Democratic Socialist Republic of Sri Lanka and KBC Bank NV of Belgium (KBC)

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Credit 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 to provide pipe born drinking water supply facilities to 50,000 consumers together with improved water supply to commercial and industrial sectors as enable to contribute to the social welfare and economic of the people living in the towns of Monaragala and Buttala and the suburban areas. The estimated total cost of the Project amounted to Euro 31.41 million equivalent to Rs.5,545.48 million and out of that the KBC Bank NV of Belgium had agreed to provide Euro 13 million equivalent to Rs. 2,291.76 million as a loan and Euro 02 million equivalent to Rs. 353.27 million as a grant under the Belgium Export portion. The Hatton National Bank had agreed to provide Euro 8.98 million equivalent to Rs. 1,590.45 million. The Project commenced its activities in 30 December 2014 and scheduled to be completed by 30 June 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 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 Credit 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 the 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 Credit 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided, and
- (c) the financial covenants laid down in the Credit Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Presentation of the Financial Statements

The financial statements of the year ended 31 December 2016 required submit to the Auditor General on or before 31 March 2017, as required by the Circular No. MOFP/ERD/2007/02 of 07 August 2007 of the Ministry of Finance and Planning had been submitted for audit only on 30 August 2017.

2.2.2 Non - Compliance with Laws, Rules and Regulations

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

- (a) Formal contract agreement of the Project required to be signed by the Secretary to the Line Ministry, as required by the paragraph 8.9.3 of the Government Procurement Guidelines had been signed by the Chairman of the National Water Supply and Drainage Board.
- (b) A monthly report on Value Added Tax payment had not been furnished to the Commissioner General of Inland Revenue with a copy to the Auditor General in accordance with the paragraph 5.4.12 of Government Procurement Guidelines, Section 21 of the Value Added Tax Act, No. 14 of 2002 and paragraph 05 of Public Finance Circular No. 364 (3) of 30 September 2002. The total amount of Value Added Tax paid during the year under review amounted to Rs.1.74 million.

- (c) According to the Section 6 (1) (a) of the Public Contract Act, No 03 of 1987 the contractors who accepted contracts Rs. 05 million or more required to be registered under the Registrar of Public Contract. Further, within 60 days after awarding the contract, the contract agreement should be registered with the Registrar of Public Contract. However, the contractor who dealt with the activities of the Project had not complied with the above requirements.

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 2016 are shown below.

Source	Amount agreed for financing in the Credit Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized during the year under review		as at 31 December 2016	
	Euro million	Rs. million		Euro million	Rs. million	Euro million	Rs. million
KBC – Loan	13.00	2,291.76	1,150.00	2.83	457.99	9.86	1,552.13
Grant	2.00	353.27		2.74	444.81	6.52	1,034.06
HNB	8.98	1,590.45	131.58	0.71	115.54	1.48	232.42
GOSL	7.43	1,310.00					
Total	<u>31.41</u>	<u>5,545.48</u>	<u>1,281.58</u>	<u>6.28</u>	<u>1,018.34</u>	<u>17.86</u>	<u>2,818.61</u>

The following observations are made in this regard.

- (a) It was observed that a Subsidiary Loan Agreement had not been signed between the National Water Supply and Drainage Board and the Government of Sri Lanka on repayment of Loans obtained from foreign and local agencies. As a result, no action had been taken to reconcile the proceeds of loans and grants aggregating Rs. 3,080.65 million received from the foreign and local agencies shown in the financial statements for the year ended 31 December 2016 with the corresponding value of Rs.2,586 million shown in the records maintained by the Department of External Resources.
- (b) Out of the allocation amounting to Rs.1,310 million made under the contribution of Government of Sri Lanka for acquisition of lands, rehabilitation of roads, rural water supply development and taxes etc, only a sum of Rs. 232.42 million equivalent to 18 per cent of the allocation had been utilized up to 31 December 2016 due to lack of comprehensive action plans prepared to achieve the financial and physical targets in timely manner.

3.1.1 Physical Progress

The following observations are made.

- (a) According to the progress reports furnished by the Project, the overall physical and financial progress of the Project at the end of the year under review was 98 per cent and 58 per cent respectively. Main activities of the Project namely, construction of water supply schemes at Buttala, Kumbukkana and Monaragala and construction of treatment plants, transmission main and office building and officer's quarters etc. in other areas had been completed and handed over to the Operational and Maintenance Division of the National Water Supply and Drainage Board at Monaragala on 01 February 2017. However, the laying of distribution lines to be carried out from the allocation made by the Government of Sri Lanka had not been completed even up to 30 October 2017.
- (b) According to the information received, 137,842 metres of distribution pipes had only been laid up to 30 October 2017, out of 350,342 metres of distribution pipes expected to be laid as at that date. Accordingly the treated water production had been increased by 12,200 litres per day. However, only 2,360 of water supply connections had been provided up to 30 October 2017.

3.3 Contract Administration

The following observations are made in this regard.

- (a) According to the information received, an unsolicited contract on civil construction works had been awarded and therefore, all other related works including rural water supply, catchment protection and laying of pipes etc also required to be carried out by the contractor. However, the contractor had signed a Memorandum of Understanding of 30 November 2015 with the National Water Supply and Drainage Board and awarded a contract to carry out the above mentioned works at a cost of Euro 500,000 equivalent to Rs. 78.51 million. It was observed that Euro 400,000 equivalent to Rs 62.81 million had been paid on 29 February 2016 as an advance to the National Water Supply and Drainage Board and Euro 100,000 equivalent to Rs. 15.70 million retained with the contractor as overhead charges. Subsequently, the National Water Supply and Drainage Board had awarded 04 sub contracts at a cost of Rs.53.70 million to carry out the respective works. Further, it was revealed that the works valued at Rs.9.48 million related to permanent reinstatement of foot pavements and roads in Monaragala area had been carried out under this contract, eventhough the allocations had been made under the contribution received from the Government of Sri Lanka.
- (c) According to the information collected from the State Engineering Corporation and the Department of Buildings, the rates applied for the construction of 02 storied administrative building, office building, officers' quarters and guard rooms etc at Kumbukkana, Horombuwa and Madulla were remained higher than standard rates.

Therefore, it was calculated that a sum of Rs.50.89 million had been overpaid on the respective construction works.

3.4 Issues on Financial Controls

The following observations are made.

- (a) The financial statements of each project should be prepared based on separate accounting records maintained by the Project as required by the Financial Regulations 626. It was observed that the general cash book of the National Water Supply and Drainage Board had been used to record receipts and payments of the Project, contrary to the above mentioned requirement.
- (b) According to the Treasury Circular No. 842 dated 19 December 1978, Fixed Asset Register of the Project had not been properly maintained.
- (c) According to the Financial Regulation 133 and Management Audit Circular No. 05 of 26 July 2010, the activities of the Project had not been audited by the Internal Audit Section of the National Water Supply and Drainage Board.