

## **Greater Kandy Water Supply Project -Phase I, Stage II - 2016**

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The audit of financial statements of the Greater Kandy Water Supply Project -Phase I, Stage II 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 Loan Agreement No. SL-P 90 dated 28 March 2007 entered into between the Democratic Socialist Republic of Sri Lanka and 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 level 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 Japan Yen 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 twice up to 20 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 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 (SOEs) 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 the 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 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 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 Presentation of Financial Statements**

According to the Circular No. MOFP/ ERD/ 2007/2 dated 07 August 2007 of the Ministry of Finance and Planning, the financial statements of the year ended 31 December 2016 are required to be submitted to the Auditor General on or before 31 March 2017. However, the financial statements of the Project had been submitted only on 28 April 2017.

### **2.2.2 Accounting Deficiencies**

The following observations are made.

- (a) A sum of Rs. 5.29 million payable as at 31 December 2016 on plots of land acquired by other projects namely Kandy North Water Supply Project and Kundasale - Haragama Water Supply Project had been accounted under this Project. In addition, a sum of Rs 12.79 million spent in 2015 for acquisition of lands for the Kandy-Pathadumbara Water Supply Project had also been accounted under this Project.
- (b) A sum of Rs.18.60 million transferred on 18 March 2016 to the National Water Supply and Drainage Board to procure a motor vehicle had been shown under the work- in progress of the Project. However, the allocations had not been utilized for intended purposes and refunded to the Project on 25 April 2017.

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

According to the schedule 2 of the Loan Agreement, general administration and other indirect expenses are not eligible for claiming purposes. However, it was revealed in test checks that the general administration and other indirect expenses amounting to Rs. 37.75 million had been claimed during the year under review, through the bills submitted by the contractors.

### **2.2.4 Funds Utilized Outside the Project Purposes**

It was observed that payments aggregating Rs. 9.23 million had been settled by the Project, eventhough the activities thereon were not directly related to achieve the objectives of the Project. Out of that, a sum of Rs. 447,880 had been charged by the contractor as overheads, eventhough no specific works assigned thereon. In addition, a sum of

Rs. 1.19 million had been remitted to the Assistant General Manager of the National Water Supply and Drainage Board in Kegalle Region to carry out a pilot project on Non- Revenue Water which was not related to the scope of the works of 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 2016 are shown below.

Source	Amount agreed for financing according to the Loan Agreement		Allocation made in the Annual Budget Estimate for the year under review	<b><u>Funds utilized</u></b>			
	JPY million	Rs. million		Rs. million	during the year under review		as at 31 December 2016
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	4,634	6,024	Nil	97.73	119.08	4,367.50	5,754.15
GOSL	863	1,122	Nil	-	-	903.56	1,108.22
	<b><u>5,497</u></b>	<b><u>7,146</u></b>	<b><u>Nil</u></b>	<b><u>97.73</u></b>	<b><u>119.08</u></b>	<b><u>5,271.06</u></b>	<b><u>6,862.37</u></b>

It was observed that the period of the Project had been extended twice up to 20 June 2017 due to delays in completion of the activities of the Project. Further, action had been taken to transfer the funds aggregating to Rs.399.17 million during the period from 26 March to 19 June 2015 to a dedicated Bank Account to meet the cost to complete the balance construction works. Out of that a sum of Rs.56.60 million had remained unutilized as at 31 December 2016.

#### 3.2 **Physical Progress**

The following observations are made in this regard.

- According to the progress report prepared by the Project, the major activities such as constructions of 08 service reservoirs, 05 pump houses for supply and laying of transmission/distribution pipe lines, installation of pumps and procurement of other related equipment etc. had been completed as at 31 December 2016 and handed over to the National Water Supply and Drainage Board.
- The Project had spent a sum of Rs.166.99 million to establish a laboratory complex at Regional Supporting Center to minimize the critical problem of Non-Revenue Water and quality of services offered by the National Water Supply and Drainage Board, domestic water meter testing and testing of bulk flow meters etc. Therefore, the Project had implemented 03 sections of testing namely, water fitting testing, domestic water meter testing and bulk flow meter testing. However, the Project had not taken action to obtain ISO 17025 Accreditation Certificate for Laboratory Testing from the Sri Lanka Accreditation Board for international recognition purposes.

#### 3.3 **Issues on Financial Control**

Transaction of the Project had not been audited by the Internal Audit Section of the National Water Supply and Drainage Board in terms of Financial Regulations 133 and the Management Audit Circular No.05 dated 26 July 2010 of the Department of Management Audit.