

Kandy City Wastewater Management Project - 2017

The audit of financial statements of the Kandy City Wastewater Management Project for the year ended 31 December 2017 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 Loan Agreement No. SL- P 99 dated on 26 March 2010 entered between Democratic Socialist Republic of Sri Lanka and the Japan Bank of International Cooperation (JBIC) presently known as Japan International Cooperation Agency (JICA).

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 objectives of the Project is to improve the living environment and water quality of Mahaweli River through better sanitation facilities by constructing a proper system for collection, treatment, and disposal of waste water in the City of Kandy including rehabilitation of sanitation facilities in densely populated areas, and thereby enhance the standard of living, health, and well-being of the people in the area. The estimated total cost of the Project is amounted to Japan Yen 17,278 million equivalent to Rs.21,982 million and out of that Japan Yen 14,087 million equivalent to Rs.17,922 million was agreed to be provided by the Japan International Cooperation Agency and the balance sum of Japan yen 3,191 million equivalent to Rs. 4,060 million was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 03 February 2010 and scheduled to be completed by 30 September 2017. However, the financial statements of the Project for the year ended 31 December 2017 had been presented for audit.

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,
- (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 Sri Lanka Accounting Standards,
- (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, 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 2017 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2017 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes, for which they were provided,

- (c) the opening and closing balances and withdrawals from and replenishments to the Special (Yen) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) 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,
- (e) The satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) The financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Presentation of the Financial Statements.

The financial statements of the Project for the year ended 31 December 2017 required to be submitted to the Auditor General on or before 31 March 2018, as per Circular No. MOFP/ERD/2007/2 of 07 August 2007 of the Ministry of Finance and Planning had been submitted for audit only on 10 September 2018.

2.2.2 Non-Compliance with Laws, Rules and Regulation.

As per the paragraph 8.9.3 of the Government Procurement Guidelines, the contract agreements of the Project are required to be signed by the Secretary to the Line Ministry. However, the respective contract agreements had been signed by the Chairman of the National Water Supply and Drainage Board.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgeting and the utilization of funds during the year under review and cumulative fund utilization as at 31 December 2017 are shown below.

Source of Funds	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilization</u>			
	JPY million	Rs. million		Rs. million	During the year under review		as at 31 December 2017
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	14,087	17,922	3,000	1,298.89	1,702.14	3,414.52	4,483.52
GOSL	3,191	4,060	147	-	82.45	-	475.72
	<u>17,278</u>	<u>21,982</u>	<u>3,147</u>	<u>1,298.89</u>	<u>1,784.59</u>	<u>3,414.52</u>	<u>4,959.24</u>

The following observations are made in this regard.

- (a) It was observed that the Project had not prepared a comprehensive plan to ensure the achievement of objectives of the Project using allocated resource within scheduled time highlighting financial and physical targets with covering entire Project period. As a result, after lapse of the 07 years and 10 months from the date commencement of the activities of the Project, only Japan Yen 3,414.52 million equivalent to Rs. 4,483.52 million representing 25 per cent had only been utilized as at 31 December 2017, out of the total amount of the Loan of Japan Yen 14,087 million equivalent to Rs.17,922 million. In addition, out of the total allocation amounting to Rs. 3,000 million made in the Budget Estimate for the year 2017, only a sum of Rs.1,702.14 million equivalent to 56 per cent had been utilized during the year under review.
- (b) As per the estimated annual fund requirement of the Project stipulated under the Schedule 01 of the Loan Agreement, the total amount of the Loan of Japan Yen 14,087 was scheduled to be utilized as at 31 December 2017. Therefore, the commitment charges amounting Rs.124.82 million had been charged up to 31 December 2017 by the Lending Agency against the undisbursed Loan balance.

3.2 Physical progress

According to the progress report prepared by the Project, the civil construction works of the Project scheduled to be carried out at a estimated cost of Japan Yen 12,034 million equivalent to Rs. 16,077 million had been divided into 04 major packages namely, the construction of Waste Water Treatment Plant, Trunk Sewers, improvement of property connection testing and construction related to improvement of sanitation facilities in the City of Kandy and the physical progress ranging from 44 to 96 per cent of the respective packages had been shown at the end of year under review, due to the delays in awarding contracts, poor performance of the contractors and inadequate monitoring mechanisms adopted by the Project.

3.3 Contract Administration

The following observations are made.

- (a) The contract of the design and construction of waste water treatment plant main pump station, treated effluent disposal system, sludge drying beds and supply of operation maintenance equipment commenced in January 2015, after lapse of 03 ½ years from the scheduled date of commencement had shown slow progress of 44 per cent as at 31 December 2017.
- (b) The contract of the design and construction of trunk sewers, branch sewers, and manhole pump stations scheduled to be commenced in July 2011 had been awarded in October 2013. Further, the works under the laying of 2,396 metres of trunk sewer pipes had been completed even up to 30 June 2018, out of the estimated length of the laying of 9,105 metres of pipes to be completed as at that date. In addition, the construction works of 02 manhole pumping stations had been completed, out of the 09 manhole pumping stations to be completed as at 30 June 2018.

- (c) As per the Project documents, the activities under the package of design and construction of property connections expected to be completed by 2017 had been commenced in July 2016. However, the works under the respective contract is agreed to be completed in 2021, without considering the date of completion of the activities of the Project 30 September 2017.

3.4 Unsettle Audit Issues Highlighted in the Previous Audit Report

As per the Section 08 of the Public Contract Act, No.03 of 1987, contractors who accepted contracts for Rs. 5 million or more should be registered under Registrar of Public Contract and the contract agreements should be registered with Registrar of Public Contract within 60 days after awarding of the contractor. However, 04 contractors who had entered in to contract agreements with the Project had not complied with the above- requirements.

3.5 Issues on Financial Controls

The transactions of the Project during the year under review was not subjected to audit of the Internal Audit Section of the National Water Supply and Drainage Board, as per the Financial Regulation 133.

3.6 Issues on Related Parties

The following observations are made.

- (a) It was observed that the Procurement Specialist deployed by the Project since September 2009 had resigned from the service of the Project in August 2016, joined to the staff of the contractor engaged in the civil construction works of the Project, as the Contract Manager in September 2016 and continued to provide the services upto 31 December 2017.
- (b) The Consultant who engaged in construction designing works of the previously implemented Project called Kandy City Wastewater Disposal Project in 2011 under the Loan Agreement No.SL-P90 had been deployed as the Consultant of this Project. The subsequent contract had been awarded under design and build basis and as a result, the respective Consultant had been allowed to review and change the design works carried out by himself at a cost of Rs 368.12 million, under the previous Project.
- (c) It was observed that 02 relatives of the Project Director had been deployed as the Quantity Surveyor and Civil Engineer under 02 contractors of engaged in construction works of the Project. According to the explanation of the Project Director, that facts had not been revealed in the financial statements as there was no influence made by them on operations of the Project.

3.7 Human Resources Management

Eventhough the post of the Project Coordinating Officer not included in the approved cadre, the Project had recruited a person for the respective post and remuneration aggregating Rs.1.33 million had been paid as at 31 December 2017.