

Water Supply and Sanitation Improvement Project - 2017

The audit of financial statements of the Water Supply and Sanitation Improvement 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 Schedule II, Section II (C) (3) of the Financing Agreement No. 5685 – LK dated 06 November 2015 and Article 4.09 (b) of the General Conditions of the Credit and Grants of the International Development Association dated 31 July 2010 entered between the Democratic Socialist Republic of Sri Lanka and the International Development Association.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement of the Project, the Ministry of City Planning and Water Supply is the Executing and Implementing Agency of the Project. The objectives of the Project are to increase access to Piped water services and improved sanitation in selected districts and to strengthen the capacity of associated institutions. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 183.90 million equivalent to Rs.27,590 million and out of that, US\$ 165 million equivalent to Rs.24,750 million was agreed to be provided by International Development Association. The Project commenced its activities on 07 December 2015 and scheduled to be completed by 31 December 2020.

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 identification 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 Financing Agreement.
- (e) Whether the opening and closing balances withdrawals from and the replenishments to the Special (Dollar) 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.
- (f) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (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 Financing 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 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 Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances withdrawals from and the replenishments to the Special (Dollar) 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 Financing 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 Financing Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) The Loan interest settled by the Government of Sri Lanka amounting to Rs.69.15 million as at 31 December 2017 had been accounted under the Foreign Loan instead of being shown under the contribution received from the Government of Sri Lanka.
- (b) The disbursements amounting to Rs.6,812.31 million made as at 31 December 2017 shown in the financial statements had not been agreed with the corresponding balance of Rs.6,738.86 million shown in the records maintained by the External Resources Department as at that date.

- (c) It was observed that salaries and allowances of the employees of the Plantation Human Development Trust aggregating Rs.2.66 million payable as at 31 December 2017 had not been taken in to financial statements.
- (d) A refundable deposit amounting to Rs.1.79 million made at the Road Development Authority on possible damages on pipe laying in Thaligama had been written off as development expenditure instead of being shown as deposits made by the Project.
- (e) Advances amounting to Rs.14.80 million made to the contractor engaged in the construction of Septage Treatment Plant at Mulathivu had been shown under work-in-progress instead of being shown under advances made to contractors.

2.2.2 Non-Compliance with Rules and Regulations

The following instances non-compliances were observed in audit.

- (a) As per the Financial Regulation 110, Project had not maintained separate register to record the losses of assets.
- (b) As per the letter of Management Services Department No. DMS/7777/WSSIP of 29 August 2017, approval had been granted to recruit 03 Programme Officers on 04 year contract basis. However, 02 officers attached to the Line Ministry had been released to the Project Monitoring Unit on part time basis, contrary to the provisions of the Circular No. 01/2016 of 24 March 2016 of the Department of Management Services.

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 2017 are shown below.

Source	Amount agreed for financing in the Financing Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
IDA	165.00	24,750	3,500	20.76	3,114	23.70	3,554.14
GOSL	5.00	750	75	0.46	69	0.72	108.59
Community Contribution	13.90	2,090	-	-	-	-	-
Total	183.90	27,590	3,575	21.22	3,183	24.42	3,662.73

Eventhough the allocations amounting to Rs.200 million and Rs.300 million had been made in 2016 and 2017 respectively under the component of Sectoral Technical Assistance in the Budget Estimates, no any activities had been implemented thereon. As a result, the entire allocations had remained unspent. Further, the allocations aggregating Rs.275 million had been allocated in the Budget Estimate for the purposes of improvement of Septage Treatment System for urban sanitation, institutional supports for the Department of National Community Water Supply and capacity building of the Plantation Human Development Trust and no activities had been implemented. However, a sum of Rs.701.22 million had been spent on Project management and administration activities, eventhough a sum of Rs.400 million had only been allocated thereon.

3.2 Physical Performance

According to the Project Documents, the activities of the Project are scheduled to be implemented under 04 Components namely, rehabilitation and expansion of urban, rural and estate water supply and sanitation schemes, strengthening of the capacity of the Department of National Community Water Supply, building of sector capacity through training and water quality mapping and Project management and administration. The activities of the Project are implemented in Ratnapura, Kegalle, Nuwara Eliya, Mulathive, Kilinochchi, Badulla and Monaragala districts. The following observations are made.

- (a) The activities of the Welipothayaya Water Supply Scheme in Ratnapura district scheduled to be completed by 07 June 2018 had shown a slow physical progress of 24.20 per cent as at 31 May 2018, due to poor performance of the contractors. Further, construction works for the use of water for Community Based Organizations, ground tank, pump house and pumps and panel boards etc, had not been commenced as planned and only 50 per cent of the pipe laying had been completed.
- (b) The contact for the construction of Thodduwakkodi Water Supply Scheme in Kilinochchi district awarded at a cost of Rs. 75.90 million was scheduled to be completed by 10 June 2018. However, only pipe laying works of 9,173 metres had been completed as at 15 June 2018, out of 9,815 metres of pipes scheduled to be laid as per the works scheduled.
- (c) The period of the contact awarded for the construction of Septage Treatment Plant at Mullaithivu at a cost of Rs.78.70 million had been extended up to 18 June 2018, due to failure of the contractor to commence the works in scheduled period and physical progress of 12 per cent thereon had only been reported as at 31 May 2018. It was observed that the contractor had retained mobilization advance amounting to Rs.14.30 million more than 01 year as at 31 May 2018, due to delays in commencement of works.
- (d) The contact for the construction of Septage Treatment Plant at Kilinochchi had been awarded to the contractor for 09 months period commencing from 17 February 2017 at a cost of Rs.74.08 million. However, the contractor had failed to complete the construction works within the contract period and the period of the contract had been extended up to 17 March 2018. Further, it was revealed at the physical verification made on 13 June 2018 that the actual physical progress of the contract remained at 50

per cent and the location selected for the construction is subjected to periodic floods and additional cost of Rs.2.87 million had been approved for the construction of a boundary wall.

- (e) It was observed that the Project had released a sum of Rs.49.54 million during the year under review to the Estate Employee Cooperatives Societies to construct 2,595 public or private lavatories under Nuwara Eliya Estate Sanitation Scheme without obtaining performance bonds. However, only a sum of Rs.12.28 million had been utilized as at 31 December 2017 to construct 307 lavatories and funds allocated for 2,288 lavatories amounting to Rs.37.26 million had remained in the hands of the Cooperatives Societies over 18 months without utilizing intended purposes. In addition, an advance payment of Rs.3.30 million had been made to a private contractor through another Corporative Society called “Dansinan Garden Cooperative Society’ to construct lavatories for estate employees and the respective construction had been abandoned after completing the works valued at Rs.1.42 million. However, no actions had been taken against the contractor to recover damages.
- (f) As per the performance report, 2,184 beneficiaries were identified in Kilinochchi district to provide sanitation facilities under the Kilinochchi Sanitation Scheme and a sum of Rs.13.58 million had been released to 09 Cooperative Societies in the area to construct 541 lavatories. However, the construction works of 214 lavatories at a cost of Rs.12.03 million had been completed as at 15 June 2018.

3.3 Human Resources Management

It was observed that the action had not been taken to fill the vacancies in 13 positions including key positions such as Engineer, Internal Auditor, Accountant and Sociologist for over 02 years as at 31 December 2017. Further, the Project had deployed 71 employees of outside institutions, contrary to the Department of Management Services Circular No. 1/2016 dated 24 March 2016 and paid a sum of Rs.13.4 million as their salaries and other allowances during the year under review.

3.4 Extraneous Payments

It was observed that a sum of Rs.6.13 million had been spent for the participation of 10 officers for a training programme held during the period from 10 June 2017 to 14 June 2017 in Indonesia, even though they are not involved on the activities of the Project.