

Dry Zone Urban Water and Sanitation Project - 2017

The audit of financial statements of the Dry Zone Urban Water and Sanitation 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 Section 2.09 of Article II of the Project Agreement No. 2477 SRI (SF) of 29 June 2009 and Grant Agreements Nos. 0129/0130 SRI (SF) of 29 June 2009 and 2977-SRI(SF) of 13 February 2013 entered between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan and Grant Agreements of the Project, then Ministry of Water Supply and Drainage, presently the Ministry of City Planning and Water Supply is the Executing Agency and National Water Supply and Drainage Board is the Implementing Agency of the Project. The objectives of the Project are to improve physical well-being of the urban population in the Northern and North Western dry zone of Sri Lanka which include Mannar and Vavuniya Districts in the Northern Province and Puttalam District in the North Western Province. As per the Loan and Grant Agreements, the total cost of the Project amounted to US\$ 163.33 million equivalent to Rs.19,165 million and out of that US\$ 99.78 million equivalent to Rs.11,809 million was agreed to be provided as a Loan and US\$ 23.22 million equivalent to Rs.2,649 million was agreed to be provided as a Grant by the Asian Development Bank. The Netherland Trust Fund (NTF) had also agreed through Asian Development Bank to make a Grant of US\$ 2 million equivalent to Rs.228 million from the Water Financing Partnership Facility and remaining balance of US\$ 38.33 million equivalent to Rs.4,479 million was required to be contributed by the Government of Sri Lanka. The Project commenced its activities on 13 November 2009 and scheduled to be completed by 30 June 2013. However, the completion date of the activities of the Project had been extended up to 31 December 2018.

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 and Grants, etc.
- (d) Whether the opening and closing balances, withdrawals from and 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.
- (e) Whether the withdrawals under the Loan and Grants had been made in accordance with the specifications laid down in the Loan and Grant Agreements.
- (f) Whether the funds, materials and equipment supplied under the Loan and Grants 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 Loan and Grant Agreements 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 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 Loan and Grant Agreements,
- (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 and Grant Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) Interest charges amounting to Rs. 185.92 million recovered by the Lending Agency up to 31 December 2017 had not been brought to work-in-progress of the Project.
- (b) Value Added Tax aggregating to Rs.133.05 million paid up to 31 December 2017 had been set off against the proceeds of contribution received from the Government of Sri Lanka, instead of being shown under the work-in-progress. As a result, the

contribution of the Government of Sri Lanka and the work-in-progress shown in the financial statements had been understated by similar amount.

2.2.2 Non - Compliance with Laws, Rules and Regulations

As per the paragraph 18 of the Schedule 05 of the Loan Agreement, respective local councils are responsible to conduct regular monitoring of the quality and quantity of treated effluent, the quality of the water in to which the effluent discharged and the bacteriological quality of dried sewerage sludge. However, no evidence had been made available on implementation of monitoring mechanism by the local councils in the areas which the activities of the Project implemented on effluent management effectively.

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 according to the Loan and Grant Agreements		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	
ADB Loan								
2477	59.78	6,820	}	1,364	2.73	325	44.02	5,922
2977	40.00	4,989		3.35	479	23.48	3,192	
ADB - Grant								
129	23.22	2,649	}	1,000	7.13	993	23.15	3,163
130	2.00	228		0.23	5	1.78	210	
GOSL	38.33	4,479	150	1.81	278	23.05	3,118	
Total	<u>163.33</u>	<u>19,165</u>	<u>2,514</u>	<u>15.25</u>	<u>2,080</u>	<u>115.48</u>	<u>15,605</u>	

Due to unrealistic cost estimation, action had been taken to increase the initial allocation of US\$ 113.33 million up to US\$ 163.33 million by the Lending Agency subsequently. However, the slow progress on utilization of funds had been reported continuously. Therefore, a sum of US\$ 115.48 million only had been utilized, out of the revised allocation even after lapse of 4 ½ years from the date of commencement of the activities of the Project.

3.2 Physical Progress

The Project had implemented several water supply and sanitation activities in the Northern and North Western Provinces in order to improve physical well-being of the urban population in such areas. According to the information received, the activities of the Project such as ground water development works, construction of new water treatments plants, supplying and laying of pipes, fixing fittings and valves for Transmission Mains and Distribution Systems in Chilaw, Puttalam, Vavuniya and Mannar areas had shown progress ranging from 40 per cent to 98 per cent at the end of year under review. Further, periodical progress reports had not been prepared in line with the action plan as enable to identify the deviations from the targets and remedial measures taken thereon.

3.3 Contract Administration

The following observations are made.

- (a) The contract of the supplying and laying of effluent outfall pipe line from Waste Water Treatment Plant to Peru Aru Reservoir in Vavuniya district had been awarded in April 2017 at an estimated cost of Rs. 88.20 million had shown slow progress of 40 per cent as at 31 December 2017, due to financial difficulties of the contractor. However, the contract period had been extended upto 20 April 2018.
- (b) The contract for the supplying and laying of 218,000 metres of pipes and fitting and fixing of valves for Water Transmission Main and Distribution System in Chilaw and Puttalam had been awarded in 2014 at an estimated cost of Rs. 1,160.58 million and scheduled to be completed in February 2018. However, only 210,630 metres of pipes had been laid even upto 31 May 2018. It was further observed that the Engineer's Estimate for the contract had not been prepared in accurate manner and as a result, the claims on price escalation valued at Rs. 181.12 million had been submitted by the contractor on additional works whilst savings amounting to Rs. 126.20 million on 14 items of works had been made upto 31 December 2017.
- (c) According to the information received, a sum of Rs. 39.16 million had been paid as at 31 December 2017 to the contractor engaged in construction of water storage structures in Mannar. However, the mandatory spare parts had not been handed over by the contractor, as required under section 6B2.14.2 of the contract agreement.
- (d) According to the contract agreement, the period of contracts such as supplying and laying of pipes and construction of water treatment plants in Vavuniya, Chilaw and Puttalam, electrical and mechanical works on ground water development in Mannar and ground water development in Murunkan new deep wells and combine wells were required to be completed as at 31 December 2017, the respective contractors are continuing the works under the contract without being obtained the extension of time from the Project to complete the works.

3.4 Unsettle Audit Issues Highlighted in the Previous Audit

Eventhough the following matters were highlighted in my previous report, the Executing Agency had not taken action to investigate the matters and take remedial action thereon during the year under review.

- (a) As per the Cabinet of Ministers decision dated 05 April 2013, action should be taken jointly by the Ministry of City Planning and Water Supply and National Water Supply and Drainage Board to implement a suitable mechanism to monitor the activities of the Project closely. However, suitable mechanism had not been implemented by the both parties even as at 31 December 2017.
- (b) The National Water Supply and Drainage Board had signed a Memorandum of Understanding in 2014 to renovate 03 tanks and revamping of lands in Pathiyakulam and Katkulam for paddy cultivation with the Assistant Commissioner of the Department of Agrarian Development in Vauniya without obtaining the concurrence of the Department of Agrarian Development. However, then Assistant Commissioner had not worked accordingly and therefore the work had been delayed. As a result, the Project had to pay additional sum of Rs. 21.8 million as compensation and other infrastructure facility in the previous years, out of the contribution received from the Government of Sri Lanka.
- (c) As per the Section 8 of the Public Contract Act, No. 03 of 1987, contractors who accepted contracts valued at Rs.5 million or more should be registered under Registrar of Public Contract. Further, the tender agreement should be registered with Registrar of Public Contract within 60 days after the awarding of the tender. It was observed that 32 contractors who entered in to contract agreements with the Project had not complied with the above mentioned requirements.

3.5 Issues on Financial Controls

The transactions of the Project during the year under review was not subjected to internal audit as per the Financial Regulation 133 and recruit an Internal Auditor as required by the Management Audit Circular No. 02/2016 of 10 June 2016.

3.6 Extraneous Transaction

The Project had taken action on 19 May 2017 to procure 02 motor vehicles at a cost of Rs 16.95 million under the approval of the Lending Agency for the use of Regional Supporting Centers in the Northern and North Western Provinces. However, respective motor vehicles had been assigned to the offices of the Southern Region of the National Water Supply and Drainage Board which are not involved to implement the activities of the Project.

3.7 Matters in Contentious Nature

Remuneration amounting to Rs.1.35 million had been paid for 14 local consultants deployed by the Project on contract of civil, electrical and mechanical works associated with ground water development activities in Chilaw and Puttalam areas without being obtained approvals from Lending Agency and the Project Director.

