

Water Supply and Sanitation Improvement Project - 2019

The audit of financial statements of the Water Supply and Sanitation Improvement Project for the year ended 31 December 2019 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 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 into between the Democratic Socialist Republic of Sri Lanka and the International Development Association . My comments and observations which I consider should be report to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement of the Project, the Ministry of Water Supply is the Executing Agency 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 was 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 financed by International Development Association. The balance amount of Rs.2,840 million is expected to be financed by the Government of Sri Lanka and through Community contribution. The Project had commenced its activities on 07 December 2015 and scheduled to be completed by 31 December 2020.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 2 of my report, the financial statements give a true and fair view of the financial position of the Project as at 31 December 2019 and its cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Generally Accepted Accounting principles, and for such internal control as management determines as necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Project ability to continue as a going concern, disclosing, as applicable, matters related to going

concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

1.6 Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Accounting Deficiencies

The following observations are made.

Accounting Deficiencies	Amount	Impacts	Responses of the Management	Auditor's Recommendations
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	Rs. million			
(a) As per section 38 of the project appraisal document, community contribution of Rs.38.26 million for the rural and estate water supply schemes and Rs.1.3 million for the rural water supply rehabilitation schemes had not been brought to the financial statements. As a result, balance of the community contribution shown in the financial position had been understated by Rs.39.56 million.	39.56	Under statement of community contribution.	Accurate community contribution amount will be identified in year 2020 financial statement.	Action should be taken to rectify the error shown in the financial statements to reflect the accurate total community contribution of the project.
(b) As per the records of Department of External Resources, US\$ 90 million equivalent to Rs.16,346.7 million had been disbursed by the Lending Agency as at 31 December 2019 and corresponding amount had been shown as Rs.14,392.03 million only in the financial statement of the Project. As a result, proceed of the Loan had been understated by Rs.1,954.67 million in the financial statements.	1,954.67	Under statement of the loan balance.	Financial statement shows accurate loan amount.	Action should be taken to rectify the incorrect loan balance shown in the financial statements.

- (c) It was observed that the cost of 10 completed and commissioned rural water supply rehabilitation projects amounting to Rs.221.80 million had been shown under the work-in-progress as at 31 December 2019 without being capitalized. 221.80 Understatement of development expenditure of water supply & sanitation infrastructure. Completed construction project cost will be identified under relevant development expenditure category in year 2020 financial statements. Value of completed and commissioned rural water supply and rehabilitation projects need to be capitalized.
- (d) Eventhough the cost of completed lavatories at the end of the year under review was Rs. 532.91 million, a sum of Rs. 273.53 million had only been capitalized as at 31 December 2019. As a result, development expenditure on water supply and sanitation infrastructure had been understated by Rs.259.38 million in the financial statements. 259.38 Understatement of development expenditure of water supply & sanitation infrastructure. Completed sanitation projects cost will be identified under relevant development expenditure category in year 2020 financial statements. Value of the completed lavatories should be capitalized.

2.2 Unsettled Balances

Description	Amount	Period of Unsettled	Impact	Response of the Management	Auditor's Recommendation
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	Rs.				
Refundable deposits Kept at Urban Development Authority and Provincial Road Development Authority.	124,019,947	Over three years	Under-utilization of project funds	It is expected to recover during 2020	Refundable deposits should be recovered without delay.

2.3 Non-compliance with Rules and Regulations

Reference to the Rules and Regulations	Non- Compliance	Impact	Management Response	Auditor's Recommendation
Section 170 (3) of Financial Regulations of the Democratic Socialist Republic of Sri Lanka.	Liquidated damages amounting to Rs.2.75 million deducted from 3 contractors during 2018 and 2019 had not been credited to consolidated fund even as at 31 July 2020.	Failure to adhere with the provisions in the financial regulations.	The amount will be transfer to the Ministry within year 2020.	Should adhere to the provisions in the financial regulations.

3. Physical Performance

3.1 Physical progress of the activities of the Project

The activities of the Project comprised with 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 and implementing such activities in Nuwaraeliya, Kegalle, Kilinochchi, Mullativu, Ratnapura, Badulla and Monaragala districts. The following observations are made.

Activities	Performance As at 31 December 2019		Delays in Days	Impact	Reasons for delays	Auditor's Recommendations
	Expected %	Achieved %				
Urban Water Supply Schemes						
Pambahinna Water Supply Project	100	62	109	Expected outcome will not be reached	Poor performances and poor cash flow of the contractors in the	i) Management should take action to complete the contract works within the given target dates.
Mulativu Water Supply Project	100	85	264			
Mulankavil Water Supply Project	100	50	329			

in timely implementation stage, ii) Time extensions should not be given for unacceptable reasons of the contractors and liquidity damages should be deducted in the events of poor performance of the contractors as per contract agreement.

manner. Covid 19 Pandemic, Easter attacks, poor community contribution, difficulties in transportation of materials, objections of the community against using the water source and (iii) The executing agency need to take early action to provide concessions to the contractors with the consultation of the General Treasury as enable to complete the activities of the Project in timely manner.

insufficient project period are the main reasons for delays.

Rehabilitation and Rural Water Supply Scheme

Kothmale (Re-group IV) Rehabilitation Rural Water Supply Scheme	90	55	87
Kiribbanwewa Rehabilitation Rural Water Supply Scheme	100	91	181
Gamunupura rural water supply scheme	100	65	31
Udubadana rural water supply scheme	100	47	321
Galpaya water supply scheme	100	82	137
Bungiriya rural water supply scheme	100	45	14
Sheengama rural water supply scheme	100	67	153
Supply and Laying of pipes for Bogawana water supply Scheme	100	80	72
Ambagamuwa, Bogawana Water Supply Scheme	100	70	29

3.2 Contract Administration

Audit Issues -----	Impacts -----	Responses of the Management -----	Auditor's Recommendations -----
<p>(a) The contract awarded for the water supply scheme of Manthreethanna in Nuwara-Eliya district at a cost of Rs.25.5 million scheduled to be completed by 09 December 2017. Subsequently, the contract had been terminated after completing 70 per cent of the works, due to poor performance of the contractor. Completion of the balance works had been awarded on 29 August 2019 to another contractor and such contractor also failed to complete the contract even by 30 March 2020, even though the date of completion was 11 December 2019.</p>	<p>i) Possibility to increase the cost of the contract. ii) Contractors will retain mobilization advance released over a period of time without utilizing for project activities.</p>	<p>The project had been completed as at 31 July 2020.</p>	<p>Need to be monitored the works regularly in order to complete within the time frame.</p>
<p>(b) The civil works contract awarded for the water supply project at Ponnagar Pathipuram at Kilinochchi district at a cost of Rs.216.93 million scheduled to be completed on 20 October 2018. Subsequently, the contract had been terminated due to poor performance of the contractor even 31 per cent of works only had been completed. Further, completion of the balance works had been awarded on 15 November 2019 to the other contractor and schedule to be completed on 28 November 2020. However, the contractor had completed 2 per cent of the works only even as at 31 March 2020.</p>	<p style="text-align: center;">-Do-</p>	<p>Project is performing according to the target time.</p>	<p style="text-align: center;">-Do-</p>
	<p style="text-align: center;">-Do-</p>		<p style="text-align: center;">-Do-</p>

(c) Rehabilitation contract for Kaudawa and Dombagahawela water supply project in Monaragala district schedule to be completed by 22 December 2019 had been terminated after completion of 75 per cent of works, due to poor performance of the contractor. However, the balance works had not been awarded even by 30 March 2020.

Tenders have been called for balance work for six months and pending approval from the PPC.

(d) It was observed that extension of time had been given to the contractors who engage in 10 water supply projects ranging from one to six instances for the same project even exceeding the original contract period and allowing to keep the mobilization advances amounting to Rs.105.19 million with the contractors without being utilized for activities of the project.

-Do-

Delays in acquisition of lands, Geographical obstacles, natural disasters due to adverse weather and community resistance to share resources and lack of cooperation were responsible for the delays in completing the projects.

-Do-

(e) As per the action plan of the Ministry of Water Supply for the year under review, Badulla - Haldummulla Water Supply scheme schedule to be commenced during the year under review. In this connection expenditure of Rs.7.06 million had been spent for the land acquisition, soil testing and research activities etc. during the year 2018 and 2019. However, contract had not been awarded even by 31 July 2020.

Project objectives cannot be met as expected within due dates.

Awaiting for additional funding for the commencement of the project.

Projects should be commenced as planned.

(f) The contract awarded on 23 May 2018 for Badulla Diyathalawa Water Supply Scheme at a cost of Rs.337.44 million scheduled to be completed within 12 months period and the contractor had been failed to commence the project activities within 42 days from the date of Letter of Acceptance given to the contractor, even after paying mobilization advances of Rs. 57.65 million on 06 May 2019. The physical progress of the scheme remained at 5 percent as at 29 October 2019 and allow to keep the mobilization advance with the contractor. Further, the contract had been

- i) Possibility to increase the cost of the contract.
- ii) Contractors will retained mobilization advance released over a period of time without utilizing for project activities.

Since the contractor has agreed to perform well, Performance and advance guarantees were recalled.

(i) Need to be monitored the works regularly in order to complete within the time frame.

(ii) For terminated contracts, performance

terminated and letter of demand had been sent to the bank on 31 January 2020 by the Secretary of the Line Ministry to encash the performance bond and advance guarantee, due to poor performance of the contractor. However, without encashing performance bond and advance guarantees the validity period had been extended by the Secretary to Line Ministry after seven months.

bonds and advance guarantees should be encashed as soon as possible without recalling as per terms of contract agreements.

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| <p>(g) It was observed that out of 25,420 of lavatories scheduled to be constructed in the above mentioned 07 districts during the period of Project, only 13,098 lavatories had only been completed at the end of the year under review. Further, out of 3,896 lavatories in Badulla district and 3,937 lavatories in Nuwara Eliya district scheduled to be constructed at the end of the year under review, 2,221 of lavatories in Badulla and 1,065 in Nuwara Eliya district representing 57 per cent and 27 per cent respectively had been completed at the end of the year under review.</p> | <p>(i) Possibility to increase the cost of construction of lavatories.</p> <p>(ii) Project objectives cannot be met as expected within due dates.</p> | <p>Construction of latrines reduced to 21,000 units as the demand in rural plantation areas was less.</p> | <p>Need to be monitored the works regularly in order to complete within the time frame.</p> |
| <p>(h) As per the initial plan of the project, 31 institutional sanitation units and 491 special need beneficiary sanitation units are scheduled to be completed at the end of the year under review. However, no single number of units had been completed even as at 31 December 2019.</p> | <p>-Do-</p> | <p>Since the construction cost of toilets for the community with special needs has increased above Rs.400,000 units, the number of units was reduced to 50 units.</p> | <p>-Do-</p> |

3.3 Underutilized Resources

Audit Issue	Impact	Response of the Management	Auditor's Recommendation
(a) Eleven vehicles had been released to National Water Supply & Drainage Board, Plantation Human Development Trust and Department of National Community and Water Supply during the year under review and Rs.14.26 million had been incurred thereon.	Utilization Project assets other than the project related activities and objectives.	Seven vehicles release to the Water Board had been returned after expiry of rent agreement. Since these institutions support to the planning and supervising of project activities these vehicles had been released to them.	Action should be taken obtain the vehicles from respective institutions.

3.4 Issues Related to Human Resources Management

Audit Issue	Impact	Response of the Management	Auditor's Recommendation
The cadre of the Project Monitoring Unit consisted with 27 positions. Out of that 57 vacancies of 15 positions including key posts such as Deputy Project Director, Engineer and Sociologist had remained unfilled for over 4 years as at 31 December 2019. Further, the Project had deployed 135 employees from the outside institutions contrary to the provision stipulated in the Circular No.01/2019 of 15 March 2019 of the Department of Management Service and remuneration aggregating Rs.57.93 million had been paid during the year under review. Out of that 24 employees had been deployed for 08 positions such as Quantity Survey, Draftsmen, Land officer, Site Supervisor which had not been approved by Department of Management Service.	(i) Performance of the project will be adversely affected. (ii) Controls on the payment of remunerations and other allowances may be weaken.	Since there was a requirement for services of a Land Officer, QS and Draughtsman, with the approval from the donor agency to increase the cadre, relevant officers were hired temporarily through service contracts until the work is completed.	Need to obtain the approval of the Department of Management Service.