

Sanitation and Hygiene Initiative for Towns Project (Phase-01) - 2019

The audit of financial statements of the Sanitation and Hygiene Initiative for Towns Project (Phase –01) 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 Section 3.4.3 (h) of the Credit Facility Agreement No. CLK 1013 – 01 K of 01 June 2016 and Financing Agreement No. CLK 1013 – 02 L of 16 March 2016 entered into between the Democratic Socialist Republic of Sri Lanka and the Agence Francaise De Development. My comments and observation which consider should be reported to parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Credit Facility Agreement and Financing Agreement of the Project, then Ministry of Water Supply and Drainage, presently Ministry of 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 are to (a) extend wastewater collection and treatment systems and improve access to sanitation services for 73,000 people in Negambo municipal council area, (b) Clarify and enhance the water and sanitation sector frame work (c) facilitate access to the service for disadvantaged households through the development of pro-poor policies designed to fight poverty (d) strategies and preserve the coastal and marine ecosystems and maintain bio-diversity. The estimated total cost of the Project amounted to Euro 107.70 million equivalent to Rs. 18,739.81 million and out of that Euro 76 million equivalent to Rs. 13,224 million was agreed to be financed by the Agence Francaise de Development as a Loan and Euro 5.70 million equivalent to Rs. 991.81 million as a Grant. The balance of Euro 26 million equivalent to Rs. 4,524 million is expected be provided by the Government of Sri Lanka. The Project commenced its activities on 01 June 2016 and scheduled to be completed by 30 June 2022.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 02 of my report, the accompanying financial statements give a true and fair view of the financial position of Project as at 31 December 2019 and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for Qualified 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 this 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 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.

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 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 Deficiency

Accounting Deficiency	Amount Rs. million	Impact	Responses of the Management	Auditor's Recommendation
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As per the statement of the Department of External Resources, the value of direct payments was Euro 2.17 million equivalent to Rs.435.56 million as at 31 December 2019. However, as per the financial statements of the Project, it was shown as Euro 2.69 million equivalent to Rs. 540.86 million. Even though the Project office had prepared the reconciliation and identified the difference of Euro 0.52 million equivalent to Rs.105.29 million, no action had been taken either Project Office or Department of External Resources to the correct amount of direct payments shown in the financial statements.	105.29	Unreconciled balances mislead the picture of the financial statements.	Reason for this is, ERD not recorded the last four drawdowns in 2019, and the exchange difference .	Action should be taken to reconcile the balances.

3. Physical Performance

3.1 Physical Progress of the activities of the Project

Activities	Physical Progress as at 31 December 2019		Impacts	Response of the Management	Auditor's Recommendation
	Expected	Actual			
(a) Construction of collection system with pump house and house connection for Negombo Wastewater Disposal System.	Contract was Scheduled to be awarded in September 2019	Contract was not awarded even up to 31 August 2020	Delaying the improvement of sanitation services in Negombo.	Initial delay due to delay in procurement of Design and Supervision Consultancy (DSC) contract. However, Designs could not be completed due to April 21 incident and the prevailing covid-19 pandemic.	Actions should be taken to expedite the Project activities since loan closed on June 2022
(b)Improvement of sanitation facilities in low income communities in the Project area.	Contracts was Scheduled to be awarded in June 2018	Contract was not awarded even up to 31 August 2020.	Delaying the improvement of sanitation facilities in the project area.	Anticipated delays in procurement process. Delay will not affect the overall project target.	Action should be taken to expedite the procurement process.
(c) Policy and Institutional Enhancement Consultancy (PIEC)	93%	32%	Delaying the enhancing of policy and institutional frame work of sewerage sector.	Initial delay due to delay in procurement. New target date is 05.09.2020. However, this contract will be affected by the prevailing covid-19 pandemic.	Action should be taken to expedite procurement process.
(d)Sewerage Management Skills Development Con-	Procurement process was scheduled to be commenced in	Procurement process was not started	Delaying the procurement may adversely affect the project ob-	Delay in awarding the PIEC contract due to initial procurement delay	Action should be taken to expedite the procurement process.

sultancy (SMSDC)	November 2018.		jectives.	contributed to delay in commencing works as PIEC consultant is responsible for the preparation of bidding documents for this contract.	
(e) Design and supervision Consultancy (DSC)	61% (Feasibility studies in Negombo, Galle & Kelaniya.)	25% (Feasibility studies for all three areas are ongoing.)	Delaying the awarding contract may adversely affect the Project objectives.	Initial delay due to delay in procurement. This contract commenced on 21.08.2018 and accordingly, design and bidding documents were expected by February 2020. But this contract is behind the schedule due to banning of drone surveys, travel bans imposed by several countries, the security issue and the prevailing COVID 19 pandemics. A time extension has been granted up to 20.01.2021.	Action should be taken to expedite the work.
(f) Land Acquisition.	12 no of land in Negombo, 17 no of land in Galle and 7 no of land in Unawatuna	Lands acquisition process are on going	Delaying the transferring the title of lands may affect the Project adversely.	Availability of access to the lands will be ensured before the commencement of construction.	The NWSDB should be taken immediate action to get transferred the ownership of the land.

3.2 Contract Administration

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
The Lending Agency had recovered a sum Rs.238 million as commitment charges on undisbursed loan balance up to 31 December 2019 as a result of the loan disbursements had been commenced in 2018 after two years from the date of the Agreements sign in 2016	Possibility of incurring additional costs to the Government of Sri Lanka.	Initial delay due to delay in procurement of Design and Supervision Consultancy (DSC) contract caused delay in commencement of work and start of loan disbursement.	Actions should be taken to expedite the consultancy contract.

3.3 Matters in Contentious Nature

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
The National Water Supply and Drainage Board had scheduled to construct a waste water treatment plant in Galle district and designing part of the treatment plant had been completed by the Project. Further, the National Water Supply and Drainage Board had selected a land for that purpose and commenced the acquisition process at the end of year 2014 and it had completed on 17 June 2019. However, the National Water Supply and Drainage Board had not been transferred legal ownership of the land even up to 30 June 2020, due to delay in judgment on case filed by the National Water Supply and Drainage Board to recover the advance already paid for the purchase of the land.	Possibility of incurring additional costs to the NWSDB	Under the provisions available in the section 92 of the NWSDB Act No. 2 of 1974, the Hon Minister by order published in the Gazette (No.1836/16 dated 2013/11/13) approved the acquisition of land called "Kanaththawatta in extract of 4 Acres and 33 purchase situated at Dadalla within four Gravest of Galle for the purpose of constructing a Wastewater Treatment Plant for Galle UC area. While proceeding with the acquisition process, action had been taken to purchase the said land through a subsequent Board decision. However, purchasing the land had been suspended due to legal issues and action is being taken to recover the advance payment through	Land acquisitions should be carried out in an effective, economical and efficient manner.

legal procedures.
 Since selected land is the technically most suitable land for the purpose Hon. Minister by order published in the gazette (No.1908 dated 2015/04/01) once again approved the acquisition. Accordingly, Board of directors at its meeting held on 08th May 2018 decided

1. NWSDB to acquire the above-mentioned land by adhering to section 92 of the NWSDB Act No 2 of 1994.
 (Since the study phase of Galle WWMS comes under SHIFT Project, only the acquisition process is closely monitored by the PMU).

2. To proceed with the legal action already initiated under the advice of Attorney General's Department to recover the advance payment made previously to Mr.J.M. Karunaratna and take disciplinary action for the responsible officers in connection to purchase of land.

3.4 System and Control
Audit Issue

----- Audit Issue -----	----- Impact -----	----- Response of the Management -----	----- Auditor's Recommendation -----
The transactions of the Project during the year under review was not subjected to internal audit as required by the Financial Regulation 133 and the Management Audit Circular No. 02/2016 of 10 June 2016.	Weakness in internal control system.	Not comment.	Action should be taken to implement an internal audit.