

## **Report of the Auditor General on the affairs of the Water Supply and Sanitation Improvement Project – Additional Financing - 2022**

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The audit of financial statements of the Water Supply and Sanitation Improvement Project - Additional Financing for the year ended 31 December 2022 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 2, Section I (B) of the Financing Agreement No. 9255 – LK dated 04 September 2021 entered in to between the Democratic Socialist Republic of Sri Lanka and the International Bank for Reconstruction And Development and the Section 07 of Project Operational Manual. My comments and observations which I consider should be reported to Parliament appear in this report.

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

According to the Loan Agreement of the project, then the Ministry of Water Supply and recently the Ministry of Water Supply and Estate Infrastructure Development is the Executing and Implementing Agency of the Project. The objectives of the Projects are to increase access to piped water services and improved sanitation in selected districts, and to strengthen the capacity of associated institutions, and in case of an Eligible crisis respond promptly and effectively. As per the additional Financing agreement, the estimated total cost of the Project was US\$ 42.74 million equivalent to Rs.12, 823 million and out of that US\$ 40 million equivalent to Rs.12,000 million was agreed to be financed by International Bank For Reconstruction and Development (IBRD).

The project had commenced its activities on 04 September 2021 under additional financing agreement and scheduled to be completed by 31 December 2023.

### **1.3 Qualified Opinion**

In my opinion, except for the effects of the matters described in the Table 2.1 of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2022 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.

## **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 scepticism 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 Deficiencies

No.	Accounting Deficiency	Amount Rs. million	Response of the Management	Auditor's Recommendations
(a)	An aggregate amount of Rs.8.81 million equivalent to US\$ 24,588.59 incurred as interest on loan disbursed during the year under review as per records maintained by External Resources Department had not been recorded in the Project financial statements at the end of the year under review. Therefore, Work in Progress balance had been understated by that amount.	8.81	This policy has been suspended by treasury from the year 2018 and also it does not show in our treasury vote reports as it is identified as government expenditure by Treasury.	Borrowing costs incurred during the Project period should be capitalized as per the State Accounts circular no 230/2013
(b)	An aggregate amount of Rs.22.3 million equivalent to US\$ 74,435.05 incurred as commitment fee on loan disbursed during the year under review as per records maintained by External Resources Department had not been accounted in the Project financial statements at the end of the year under review. Therefore, Work in Progress balance had been understated by that amount.	22.3	Since it does not show in our vote reports, it is also not identified as a project expense like the previous deficiency.	Borrowing costs incurred during the Project period should be capitalized as per the State Accounts circular no 230/2013
(c)	The Exchange rate difference of Rs. 16.31 million had not been adjusted in the books of accounts in relation to the Front End Fee. Therefore Loan balance had been understated by that amount.	16.31	We have taken into accounts for the Central Bank received date exchange rate and External Resources Department accounts according to the monthly average rate. But, as per the LKAS 21, WB Loan recognized on December 31, 2022, the average exchange rate amount adjustment was done by JV no. 5.	Exchange rate difference should be adjusted correctly at the end of the year under review.

**3. Physical Performance**

**3.1 Physical Progress of activities of the Project**

According to the action plan, 14 activities had been scheduled to implement during the year under review. However, only 10 to 51 per cent of achievement was reflected out of 50 per cent to 85 per cent physical progress was expected from 06 activities. Further, Zero progress was indicated on balance eight activities which were planned to achieve 40 per cent progress from one activity and 25 per cent progress from 7 activities during the year under review. The management has mentioned that external environmental impacts and delay in procurements were as reasons for this delay. However, 15 months had been spent out of 27 months duration of the Project period as at 31 December 2022. Therefore, it was observed that there was a risk of incompleteness of the project within the scheduled period if the management did not take remedial actions to overcome above identified issues and keep close supervision on this project.

**3.2 Issues Related to Human Resources Management**

<b>Audit Issue</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
Even though the salaries of all staff of the Project for the month of November and December had been spent from the current financing agreement, the amount of Rs.13.9 has spent from the additional financing arrangement for salaries in the month of October 2022. However, manpower requirement for the additional finance utilization had not been planned to execute the Project and to identify the cost of the staff who were engaged to the additional financed project.	Since the salary is a project management cost and it falls under "Project Management Support" Component 4 in both funds, we used additional financing to pay 1 month salary payment, as the project staff engaged for both funds.	Carder requirement for the Project under Additional Financing should be established.