

## **Sanitation and Hygiene Initiative for Towns Project - (Phase – 01) -2024**

---

The audit of financial statements of the Sanitation and Hygiene Initiative for Towns Project (Phase 01) for the year ended 31 December 2024 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 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 Credit Facility Agreement and Financing Agreement of the Project, then Ministry of Water Supply, presently the Ministry of Urban Development, Construction and Housing 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 extend wastewater collection and treatment systems and improve access to sanitation services for 73,000 people in Negombo municipal council area, Clarify and enhance the water and sanitation sector frame work, facilitate access to the service for disadvantaged households through the development of pro-poor policies designed to fight poverty, strategies and preserve the coastal and marine ecosystems and maintain bio-diversity.

The estimated total cost of the Project was 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 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 required to be contributed by the Government of Sri Lanka. The Project commenced its activities on 01 June 2016 and scheduled to be completed by 30 June 2022. The Project had been temporarily halted as at 30 April 2023 due to lending institution had stopped money disbursing.

### **1.3 Qualified Opinion**

In my opinion, except for the effects of the matters described in the section 2.1 of this report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2024, financial performance 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 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 Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

## **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

Accounting Deficiencies	Response of the Management	Auditor's Recommendations
Commitment charges of Rs. 465 million, appraisal fees of Rs. 61 million, and loan interest of Rs. 16 million had not been accounted and shown in the financial statements. As a result, the loan balance and the work-in-progress had been understated by Rs. 542 million as at 31 December 2024.	The above project is a grant funded project. The commitment fees and loan interest related to the said project are borne by the Ministry of Finance.	These accounting errors should be rectified.

## 3. Physical Performance

### 3.1 Physical progress of the activities of the Project

The project, which commenced in June 2016 with an expected completion in June 2022, and it encompasses three main components. Feasibility studies for all three areas, preliminary designs for Negombo, Galle, and Unawatuna, as well as detailed designs and preparation of bidding documents for Negombo and draft detailed designs and preparation of draft bidding documents for Galle, have been completed when the project temporarily closed on 30 April 2023 based on the RAMP Committee recommendation dated 28 October 2022.

Project component	As at 31 December 2024		Audit issue	Response of the Management	Auditor's Recommendations
	Expected physical performance Percentage	Performance achieved Percentage			
Studies and construction of sewerage infrastructure for Negombo city Studies and tender documents for sewerage infrastructure for Galle/Unawatuna and Kelaniya/Peliyagoda and Technical assistance and capacity building of the sewerage sector.	100	12	No work contracts had been awarded, and approximately 94 percent of the proposed loan amount remained unutilized by the time of cancellation. As of 31 December 2024, the overall physical progress stood at only	Due to various reasons the Project work had been delayed and the loan had been underutilized.	Actions should be taken to re-start the project.

12.31 percent, despite the project having continued for more than seven years.

### 3.2 Contract Administration

Audit issue	Response of the Management	Auditor's Recommendations
<p>As at 31 December 2024, a total of Rs. 1,669 million had been incurred on the project, comprising Rs. 221 million from the Government of Sri Lanka and Rs. 1,448 million from the lending institution. Out of that Rs. 1,425 million had been spent under a consultancy contract, which resulted only in the preparation of detailed design and bid documents for the Negombo Wastewater Treatment Plant, and feasibility studies and basic designs for wastewater systems in Galle, Unawatuna, and Kelaniya. However, all major construction activities remained at the procurement stage without any physical or financial progress.</p>	<p>Although the physical work had not been completed, the design and tenders for the Negombo wastewater project had been completed.</p>	<p>Project works should be completed within the scheduled time to achieve the expected objectives.</p>

### 3.3 Extraneous Activities made out of the project objectives

Audit Issue	Response of the Management	Auditor's Recommendation
<p>(a) According to Cabinet Decision No. 23/1879/611/027 dated 07 November 2023, the Secretary to the Ministry was directed to take necessary steps regarding the project's activities after the completion of the debt restructuring process and upon identifying a specific financing method. However, despite this directive, the Secretary had not provided any firm confirmation as to whether the project had been officially suspended or continued.</p>	<p>The outstanding amounts in our accounts with the lending institution were given to ERD on 2024/12/31 and 2025/03/24. Meanwhile, the closure notice has still been delayed by the ERD as the funds have not yet been credited to the relevant loan institution.</p>	<p>Cabinet decision should be followed.</p>

- (b) As of 31 December 2024, the project was discontinued without achieving its expected outputs, despite the Government of Sri Lanka incurring Rs. 1,890 million in initial costs, placing the entire investment at risk of becoming a sunk cost. Intended to support the sustainable development of tourism through essential wastewater infrastructure, the project's non-implementation has not only resulted in direct financial loss but also jeopardized the growth and viability of tourism activities in Negombo, Galle, Unawatuna, and Kelaniya, depriving the country of both immediate and long-term economic benefits.
- It should be noted that although the project could not be completed due to the decision taken by the government due to the economic crisis in Sri Lanka. Action should be taken to mitigate the existing risk on losing the project cost.

### 3.4 Underutilized Resources

Audit Issue	Response of the Management	Auditor's Recommendation
(a) Even though the project should be completed on 30 June 2022 after 06 years, as of 31 December 2024 the project had achieved only 12.31% physical progress, while AFD had committed EUR 76 million in loans and EUR 5.7 million in grants; however, only EUR 4.74 million (6%) of the loan and EUR 2.14 million (38%) of the grant were utilized, resulting in the cancellation of rest amount of grant and loan.	Delay in land acquisition caused by public protests impacted the selection of land for a sewerage project, and since land location directly influences the design of pumping stations and wastewater systems, related activities could not be completed on schedule.	Loan fund should be utilized effectively.
(b) The slow utilization of funds resulted in the Government incurring commitment charges of Rs. 465 million during the period under review. These charges were borne without any economic benefit to the country.	Due to various reasons mentioned above, the project was unable to be complete within the agreed loan period.	Loan fund should be utilized effectively.