

Kandy City Wastewater Management Project - 2022

The audit of financial statements of the Kandy City Wastewater Management Project 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 Loan Agreement No. SL- P 99 dated on 26 March 2010 entered between the Democratic Socialist Republic of Sri Lanka and the Japan Bank of International Cooperation presently known as Japan International Cooperation Agency. 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 Ministry of Water Supply and Drainage, presently the Ministry of Water Supply and Estate Infrastructure Development 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 improve the living environment and water quality of Mahaweli River through better sanitation facilities by constructing a proper system for collection, treatment, and disposal of waste water in Kandy City, including rehabilitation of sanitation facilities in densely populated areas, and thereby enhance the standard of living, health, and well-being of the people in the area. The estimated total cost of the Project is amounted to Japanese Yen 17,278 million which equivalent to Rs.21,982 million and out of that Japanese Yen 14,087 million which equivalent to Rs.17,922 million was agreed to be provided by the Japan International Cooperation Agency and the balance sum of Japanese yen 3,191 million which equivalent to Rs. 4,060 million was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 03 February 2010 and scheduled to be completed by September 2017. Subsequently, the period of the Project had been extended up to 31 December 2022.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 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 2022, 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 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

No	Accounting Deficiency / Audit Issue	Response of the Management	Auditor's Recommendations
(a)	The gratuity provision of Rs. 3.5 million had not been made for 17 employees who works in the project from the year 2010 according to the Sri Lanka Accounting Standard No 37.	The appointment, salary preparation and payment of the staff of the project is done by the head office and the head office should also make the allocations related to this gratuity allocation.	Should be complied with accounting standards.
(b)	Total amount of Rs. 6.3 million valued office equipment and computer items had been accounted as work in progress contrarily to the Paragraph 07 of Sri Lanka Accounting Standard No 16.	We will remove those Assets from the Work-in- Progress Account and show them under Non-Current Assets as per the audit explanations	Should comply with accounting standards.
(c)	The value of a truck which had been supplied by a contractor at a Rs. 16 million and used for project construction works by Kandy Municipality from July 2022, had not been accounted. Accordingly the value of non-current assets and accrued expenses had been understated by the same amount as at 31 December 2022	Once the full payment is released to the contractor, project will account the payment to the vehicle WP DAH-8099 as the Asset.	Action should be taken to correct the relevant ledger accounts.
(d)	Payment of Rs 1.1 million for purchase of two lands had not been accounted and accordingly the balance of non-current assets had been understated by same amount.	we wish to inform you that all the lands related expenditure related to the project will be obtained from the relevant units and the same will be capitalized.	This accounting error should be rectified
(e)	National Water Supply and Drainage Board had paid Rs. One million to Gangawata Korale Divisional Secretary for the acquisition of a land for construction of waste water Pumping Station under the project and that amount had not been debited to the land account. Accordingly, the value of lands as at 31 December 2022 had been understated by that amount.	we wish to inform you that all the lands related expenditure related to the project will be obtained from the relevant units and the same will be capitalized.	The land should be taken over in formal way and accounted correctly.

- (f) As per the letter No FP/06/20/03/119 dated 17 January 2014 issued by The Ministry of Finance, the materials purchased for the project had been exempted from VAT and customs duties. However, the exempted amount of Rs. 1,418.2 million VAT and customs duty for the purchased materials as at 31 December 2022 was recorded in the work in progress and GOSL account. Accordingly, the value of the work in progress and the loan of GOSL had been overstated by that amount.
- These exempted VAT and customs duties cost have been accounted as an expenditure of the project and taken into the Loan & Grant Account (Local).
- Should be corrected the existing accounting error

2.2 Non Compliance with Laws, Rules and Regulations

Reference to the Laws Rules and Regulations	Non Compliance/Audit Issue	Response of the Management	Auditor's Recommendations
Management Audit Circular 02/2016	Action had not been taken to appoint an Internal Auditor from the beginning of the project until 31 December 2022 as per the instructions mentioned in the circular	Project has already informed to the Head Office on this regard	Continuous internal checks should be conducted on the activities of the project.

3. Physical Performance

3.1 Physical progress of the activities of the Project

No	Project component	Audit issue	Management Response	Auditor's Recommendation
(a)	Package 1 Wastewater treatment Plant	- According to the agreement, the warranty period of the equipment had been given up to July 2025, however the contractor had stopped the activities to be carried out according to the agreement by 31 December 2022. However, the contractor had not dealt with fixing 26 cases of defects identified in the equipment and actions had not been taken by the project on this regard in accordance with the above agreement.	Based on the defects identified, letters of demand sent to the bank to encash the bond of relevant estimated cost as per the warranty agreement.	Continuous internal check should be conducted regarding the performance of the installed equipment and action need to be taken to recover the damages

(b) Package Property Connections	3-	As per the implementation plan the contract should be completed on July 2021 but it had not been completed as planned and was suspended on 21 October 2022. Although it has planned to connect 9,502 Domestic and non-domestic sewerage connections to the main sewerage network, as on 31 December 2022, only 6,063 connections had been constructed and 3,769 connections had been connected to the main sewerage network.	Suspension was issued to reduce the additional cost as the contractor maintain same preliminaries without progress due to default of progress payment.	Action should be taken to achieve the Project objectives without being delayed.
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3.2 Contract Administration

Audit Issue

According to the provisions mentioned in Para No. 14.7 of the FIDIC Guidelines, the settlement of guaranteed intermediate payments should be done within 56 days from the date of receipt of the bills, but arrangements had not been made for the settlement of five bills valued at Rs. 97 million related to the previous years and 15 bills valued at Rs. 284 million related to the year under review which were been exceeded the due dates as per the guideline. Accordingly it was observed that a serious risk on delay payments.

Response of the Management

Payments were delayed due to budget approval delay and subsequently delayed due to JICA's refusal to disbursement as the Government of SriLanka informed default in repayment of loans.

Auditor's Recommendation

Action should be taken to settle outstanding bills without being delayed.

3.3 Extraneous Activities

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	According to the annual board of survey report for the year 2022, it was observed that total amount of Rs. 5 million valued computers, and office equipment had not been physically exist. However action had not been taken on this regard as per the finance regulations.	After 31.12.2022, the project has verified and confirmed with the Kandy Municipal Council that these items are in the Kandy Municipal Council building which was used by the Consultant's Staff.	Action should be taken to submit the verification reports to the Audit.
(b)	Audit of the vehicles valued at Rs. 323 million and handed over to the National Water Supply and Drainage Board could not be finalized due to non-submission of verification reports,	This has been informed to the DGM (M&E) accordingly.	Action should be taken to submit the information to the Audit.

3.4 Matters in Contentious Nature

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	According to the information submitted to the audit, only 02 lands out of 09 which had been used for project works had completed the acquisition process even it has passed 20 years at the date of audit 09 June 2023 from beginning of that activity.	The reply sent by the Land Section, NWSDB is attached herewith.	Action should be taken to complete the land acquisition without delay.
(b)	According to the assessment letter No. LAND/CE/KAN/GEN/3833 and dated 09 June 2023, compensation for acquisition of land for the construction of the main pumping station related to the project, was Rs. 3 million later the land owner has submitted an appeal to the Compensation Review Board mentioning that the assessed value was insufficient. However the final decision had not been received by 07 June 2023.	Land Acquired and MPS was already constructed and under operational condition. Only land owner's appeal to be settled as he demands for higher compensations.	Action should be taken to settle the land acquisition without delay.