

FINANCIAL MANAGEMENT ASSESSMENT

EXECUTIVE SUMMARY

1. The Financial Management Assessment (FMA) was conducted in accordance with the Guidelines of the Asian Development Bank (ADB) for the *Financial Management and Analysis of Projects (2005)*, the *Financial Due diligence: A Methodology Note (2009)*, and the *Financial Management Technical Guidance Note (2015)*. The FMA considered the financial management capacity of the National Water Supply and Drainage Board (NWSDB) in its role as the implementing agency for the proposed additional financing of the Jaffna Kilinochchi Water Supply and Sanitation Project (JKWSSP), including funds-flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements.
2. The NWSDB will be responsible for overall management, supervision, and execution of the proposed additional financing as implementing agency through the project management, coordination and implementation unit (PMCIU). The existing PMCIU, which is implementing the current project, will implement the proposed additional financing as well. The same arrangements will help the smooth implementation of the proposed additional financing by utilizing the experience of implementation of the current JKWSSP including financial management. NWSDB has considerable experience in implementing donors assisted projects funded by ADB, World Bank and Japan International Cooperation Agency (JICA).
3. The dedicated project director is and will be assisted by a team of technical and non-technical officials to manage both the current project and the additional financing on full time basis. The existing PMCIU of JKWSSP will be responsible for all day-to-day management of the additional financing, including but not limited to: (i) preparing an overall project implementation plan and detail work program; (ii) providing overall monitoring and guidance on the implementation; (iii) monitoring and supervising all management activities; (iv) preparing project progress and project completion reports; (v) financial planning and budgeting including contract awards and disbursements; (vi) approving under the additional financing; and (vii) ensuring full compliance with ADB's resettlement, environmental and other safeguard policies. The existing PMCIU will be staffed with qualified accountants with a project accountant and an account assistant to manage the additional financing as well as the overall fund management.
4. The existing PMCIU, which acts as a coordinating agency of the implementing agency in representing the current project, faced some key issues related to the financial management. These included the use of inefficient manual accounting systems, insufficient experience and qualifications of the accounting staff and inadequate financial accounting processes. While it is not an issue directly impacting NWSDB, planned tariff increases have not taken place and would adversely impact on the financial sustainability of NWSDB and the project viability.
5. The major risk factors identified during the assessment that need to be addressed include:
 - (i) Inadequate staff in the internal audit division of NWSDB which will affect the quality and delay in submission of auditing reports;
 - (ii) Inadequate revisions¹ in water tariffs which will hamper the medium and long-term financial sustainability of NWSDB;

¹ The tariff increase of 30% in 2016 was not approved by the government. NWSDB submitted the tariff increase proposal again to the government in 2017.

- (iii) Lack of experience and qualifications of the accounting staff which will affect the quality and delay in submission of financial reports; and
- (iv) Inadequate needs identification at the early stage of the design of accounting system leading to continuous modifications and improvements to the system.

6. Despite the highlighted risks, the financial management arrangements are satisfactory taking the ongoing actions of NWSDB into consideration. In addition, the project management consultants (PMCs) will support NWSDB in enhancing its financial management capacity. The overall risk assessment for the proposed additional financing is “Moderate”. The action plan for mitigating the foreseen risks includes the following measures:

- (i) Strengthening the internal audit division of NWSDB by appointing and recruiting qualified staff to fill the existing vacancies;
- (ii) Continuing policy dialogue with the government for approval of regular tariff adjustment and establishment of independent regulatory on water tariffs;
- (iii) Extending full training and capacity building support with the help of PMC for strengthening the accounting staff of NWSDB; and
- (iv) Update and modification of the accounting system with the support of PMCs.

A. Introduction

7. This FMA was conducted in accordance with ADB Guidelines for the Financial Management and Analysis of Projects (2005), the Financial Due diligence: A Methodology Note (2009), and the Financial Management Technical Guidance Note (2015).

8. The FMA considered the financial capacity of NWSDB, which will be responsible for overall management, supervision, and execution of the proposed additional financing as the implementing agency along with its PMCIU, including funds-flow arrangement, staffing, accounting and financial reporting system, financial information system, and internal and external auditing arrangement.

9. A key aspect of FMA is evaluating the risks associated with financial arrangements of the proposed additional financing. ADB’s principal concern is to ensure that project funds are used economically and efficiently for the purpose intended. In support of this, it seeks assurance that the financial management system of the implementing agency can report on the source and use of the project funds. The assessment was based on the results of the FMA questionnaire, discussions with NWSDB officials, and information available through various reports.

10. The FMA has considered two types of risks (i) inherent risks; i.e. risks outside the direct control of the financial management of implementing agency; and (ii) control risks; i.e. risks concerning the internal functioning and control of the finance and accounting division of implementing agency.

B. Brief Project Description

11. With the objective of contributing to sustained economic growth and uplift the condition of the country by improving the infrastructure of the water supply network, ADB approved the Jaffna

Kilinochchi Water Supply and Sanitation Project (JKWSSP)² in November 2010. JKWSSP has the following three components: (i) improving water supply for 300,000 people by transferring water from Iranamadu tank and improving the sanitation infrastructure for 80,000 people in Jaffna; (ii) strengthening Jaffna water resource management by improving the Iranamadu tank; and (iii) building the capacity of NWSDB in project implementation and developing their regional office in Jaffna.

12. However, the current project needs to be restructured mainly as the result of change of water source from Iranamadu tank to a desalination plant. In view of the weak implementation capacity and inordinate delays in project implementation, some of the project components, namely sewerage, needs to be dropped so that the project can focus more on urgent challenges of drinking water supply. The following restructuring is proposed: (i) inclusion of a design-build-operate (DBO) for a desalination plant; (ii) cancellation of the Agence Française de Développement (AFD) cofinanced (\$40 million) water treatment plant and bulk water transportation from Iranamadu tank; (iii) exclusion of the sewerage component; (iv) inclusion of the household water connections; and (v) inclusion of strengthening the water resource management and outreach activities in Jaffna.

13. The impact of the current project and additional financing is improved health and human development in urban areas of Jaffna Peninsula with an outcome that will improve the water supply for residents and returning internally displaced persons in targeted urban areas, and improve protection and management of Jaffna Peninsula's water resources. In addition to maintaining the restructured current project, the additional financing will be used to: (i) finance the shortfall under the current project; (ii) support additional activities of the desalination plant and related works under Output 1; and (iii) support the additional activities of water resource management plan under Output 3. The overall project has following outputs: (i) water supply infrastructure and service in Jaffna Peninsula improved; (ii) headworks at the Iranamadu water tank improved; and (iii) water resource management plan and activities developed and capacity of NWSDB strengthened.

14. The FMA is based on the results of a FMA questionnaire, discussions with officials of implementing agency, and information available through various reports including the Annual Report of implementing agency.

C. Country and Sector Financial Management Issues³

15. Since the end of the military conflict in 2009, Sri Lanka has experienced healthy economic growth with real GDP growth averaging 7% from 2012-14. The Sri Lankan government has prioritized its commitment to improved Public Financial Management (PFM) while preserving fiscal sustainability and macro-economic stability and growth.

16. The current vision of the Sri Lankan Ministry of Finance (MOF) is "to create a sound public finance regulatory framework to improve transparency, accountability and service delivery in the public sector." In the recent implementation of the accrual accounting and the use of Sri Lanka

² ADB. 2010. Report and Recommendation of the President to the Board of Directors: *Proposed Loan to the Democratic Socialist Republic of Sri Lanka Jaffna and Kilinochchi Water Supply and Sanitation Project*. Manila (Loan 2790-SRI).

³ The most recent Country Partnership Strategy, that is typically used for this section of the FMA was done in 2011 for the period 2012-16 and is now outdated and the interim CPS for 2015-16 had limited information. The information in this section was therefore sourced from various other published reports, in particular, United States Agency for International Development Report on "Sri Lanka Public Financial Management Assessment Report, June 2015" is acknowledged.

Public Sector Accounting Standard (SLPSAS) by the public institutions is a major improvement in the PFM. New requirement of the MOF to have the Internal Audit units in all projects also a new requirement of improvement in the PFM.

17. **Institutional Capacity.** According to the IMF,⁴ the capacity of Sri Lankan MOF needs strengthening. There is an on-going project to introduce a Financial Management Information System (FMIS) to systematize budget processes and procedures throughout the public administration. Currently, the Sri Lankan MOF still uses a manual, paper-based process to transmit decisions to line-ministries and government agencies and to receive updates from them.

18. **Financial Management Risks.** Some of the main areas of PFM risks are on budget preparation and approval, planning, budget execution, budget control and transparency, and corruption.

19. **Budget Preparation and Approval**

- a. Lack of adequate budget institutions (norms, process and procedure) for budget planning and execution:
 - (i) The legal framework and executing institutions responsible to draft and execute the budget are not fully operational and lack coordination;
 - (ii) Despite positive economic growth in GDP terms, Sri Lanka's debt has increased over the last ten years and, according to IMF, it has surpassed international standards thresholds; and
 - (iii) The institutions responsible for budget planning and execution have lost control over spending and debt issuance, have lost credibility, leading to opacity and lack of transparency, contributing to inefficiency, mismanagement and the heightened perception of governmental corruption.
- b. Optimistic budget forecasts continuously demand financial supplements while checks and balances and accountability mechanism are absent.
 - (i) The parliament is not structured to provide analysis and support in regards to budget matters and oversight (revenue, expenditures and debt management).

20. **Planning: Strategic Allocation of Resources**

- a. Lack of the government's strategic vision on economic, social and political issues to guide the allocation of public resources as well as the institutional and organizational framework to support it; and
- b. Insufficient capacity of the government to manage public investment funds from the Central Bank of Sri Lanka and external funding sources.

21. **Budget Execution: Procurement**

- a. Lack of institutional capacity to promote tender competition and retaining the best value for the government.

22. **Budget Control: Auditing and Monitoring and Evaluation**

- a. Lack of ongoing audits: The last audit reform in Sri Lanka was completed in 1992.

23. **Transparency and Corruption**

⁴ IMF's Article IV for Year 2013 and 2014 figures.

- a. The lack of transparency on budget planning and execution as well as financial decision-making:
 - (i) The public does not have access to information on previous, current, and projected financial matters of the government. The budget information available is untimely and incomplete.
- b. Increasing public perception of corruption:

D. Project Financial Management System

24. **Overview.** The NWSDB is an entity established by an Act of parliament called NWSDB Act No. 2 of 1974 and NWSDB (amendment) Act No 13 of 1992. The areas of authority describe the activities in the above noted acts as: (i) to develop, provide, operate, and control an efficient, coordinated water supply and to distribute water for public, domestic or industrial purpose; (ii) to establish, develop, operate, and control efficiently coordinated sewerage systems; (iii) to take over and carry out any water supply and sewerage undertaking transferred to the board; (iv) to provide supply of water and distribute or sell water in any form; and (v) to do all other acts and things as may be necessary in any part of Sri Lanka for the discharge of its function.

25. The NWSDB has its head office in Colombo with other support divisions and the national network of water and sewerage operations are carried out by 11 regional support centers (RSCs). The total employee strength is 10,662 shown in 2015 budget. Operations serve an estimated 8 million people with 2 million connections. Responsibility and authority for day-to-day administration, planning, procurement, capital works, and operation and maintenance of schemes are devolved to RSCs. All water revenues are remitted directly to the Ratmalana (Colombo) head office through nationwide banking network facilities. A number of the country level public sector risks are not applicable, since NWSDB, as a state-owned enterprise, is required to comply with corporate financial reporting including compliance with IFRS, accounting and auditing framework.

26. **Experience of managing externally financed projects.** During the recent years, NWSDB managed several externally funded projects of ADB, WB and JICA. According to the subsidiary lending arrangements established between the Government of Sri Lanka and NWSDB, the loans from development partners will be provided from the government to NWSDB in a mix of grant and loan. The grant to loan ratio will depend on the type of investment.

27. **Funds flow arrangements.** The NWSDB obtains funds from the national budget and various development partners. The NWSDB also obtains funds from the sale of water collected from the collection centers all over the country. Like most foreign funded projects, ADB funds flow through an imprest account opened by PMCIU at the Central Bank of Sri Lanka. Counterpart funds flow through the national budget allocated to the Ministry of Water Supply and Drainage (MWSD) made available through MOF to the line ministry to PMCIU.

28. **Staffing.** The NWSDB accounts division is headed by the Additional General Manager Finance. He is supported by two Deputy General Managers and five Assistant General Managers with nine Chief Accountants in the head office and 11 RSCs where the subject accountants supported by the support staff. All the staff is permanent NWSDB officers of different services. All the officers are transferable after serving 5 years at any one office. Internal audit division of the NWSDB is also under a Deputy General Manager.

29. The PMCIU of the current and proposed JKWSSP accounts division headed by a project accountant and supported by one accounts assistant and one accounts clerk. This was the approved cadre for PMCIU. All officers are on contract basis and appointed for the project. The

support staff need to be trained further on ADB procedures as they lack previous project experience.

30. **Accounting policy and procedures.** NWSDB keeps its all financial transactions following the financial regulations of the government and rules and the regulations of NWSDB. It follows accrual basis accounting in accordance with Sri Lanka Accounting Standards and consistent with International Accounting Standards. Same policies and procedures are followed by PMCIU.

31. **Segregation of duties.** The organizational system of NWSDB ensures adequate segregation of duties where works and administration divisions are respectively responsible for ordering and receiving. The accounts division is responsible for the payment. In the accounts division, all important activities like authorization, recording, payments, and reconciliations are segregated and carried out by different officers.

32. Same systems are followed by PMCIU. But, due to the existing vacancies in the accounts division of PMCIU, some of the activities cannot be segregated and are carried out by the same officer.

33. **Budgeting division.** The NWSDB accounts division obtains information from other divisions and prepares the budget. Responsibility for the budget preparation lies with the Chairman of NWSDB. Budget is submitted to the Board of Directors of NWSDB.

34. To obtain national budget allocation, NWSDB needs to provide the details to the Department of National Budgets (NBD) of the Ministry of finance (MOF) through its line ministry. The NBD is responsible for the overall preparation of the national budget. After the approval by the Parliament, the budget becomes the National Budget of Sri Lanka where allocations are available to NWSDB through the line ministry. Same procedures are followed by PMCIU of JKWSSP. But, according to the internal audit report on JKWSSP, the update of the vote ledger has not taken place as and when payments are made resulting from deficiencies in the budgetary control procedures.

35. **Payments.** Payments are made against invoices and other supporting documents submitted for payments to the accounts division. Adequate safeguard procedures are in operation for approval of expenditure against the budget allocation. Same procedures are followed by PMCIU of JKWSSP.

36. **Cash and Bank.** The operation of the bank account lies with the head of NWSDB and the RSCs. The revenues collected by the collection centers are transferred to NWSDB bank accounts maintained by the head office. The accounts division is responsible to ensure reconciliation with accounting records and bank statements on daily and monthly basis.

37. For the proposed additional financing, the operation of the bank accounts lies with PMCIU of JKWSSP. PMCIU is responsible for the reconciliations on monthly basis and the reconciliations are up to date.

38. **Safeguard of Assets.** The records of NWSDB's fixed assets are maintained at the RSC level. Adequate asset registers are maintained by NWSDB where available procedures guide the annual verification of the assets. Some of the assets are covered by insurance policies. Reconciliation of records after the annual verification does not take place always with asset registers or the control accounts.

39. Adequate asset registers are maintained by PMCIU where NWSDB procedures guide the annual verification of the assets.

40. **Contract management and accounting.** The NWSDB maintains all records including accounting records, and contracts which enable NWSDB to effectively monitor contracts and details of related payments.

41. The PMCIU of JKWSSP maintains all records including accounting records and details of contracts records which enable PMCIU and NWSDB to effectively monitor contracts and details of related payments.

42. **Internal audit.** A separate internal audit division operates in NWSDB housed in the head office with subunits in the RSC. Audit is carried out following an approved program. An audit committee that includes the board members has been appointed and is in operation.

43. Internal audit directly reports to the Chairman and works closely with the audit committee. The head of the division is a Chartered Accountant and the other staff includes officers with appropriate technical knowledge (including engineering, accounting and risk management etc.). However, 15% of the approved cadre positions are vacant. The division only reviews post audit transactions. Internal audit is carried out according to the program approved by the audit committee.

44. As staff is limited, internal audit division has to prioritize its operations restricting audit of project related activities or entity related activities. This has resulted in delay in issuing audited reports.

45. **External audit.** Auditor General of Sri Lanka is the external auditor of NWSDB according to the statute and the finance act. The annual audit is carried out by the Auditor General and the report should be available within the end of nine months (before 30 September of the following year).⁵ Auditor General of Sri Lanka is the external auditor of PMCIU of JKWSSP.

46. **Reporting and monitoring.** The reporting is done on monthly, quarterly, and annual basis for NWSDB. The monthly, quarterly, and annual statements of NWSDB are prepared in accordance with financial regulations of the government and NWSDB. The annual accounts are prepared in accordance with Sri Lanka Accounting Standards and comply with the International Accounting standards. Financial statements are prepared on an annual basis using the computerized accounting system.

47. Same procedures are followed by PMCIU of JKWSSP. Financial statements are prepared on annual basis using manual accounting records. Lack of controls exists in operation and maintenance of the manual accounting records using Excel. No procedure is being followed in entering data into the general ledger. Due to this, updates do not take place as and when transactions take place. The existing classification of accounts to identify expenditure does not represent the loan categories. Update of the ledger do not take place as and when transactions take place making room for deficiencies in the budgetary control procedures.

⁵ Financial year for all public entities (PMCIU) in Sri Lanka is the calendar year and end on 31December. All these entities (PMCIUs) have to submit their annual accounts to AG on or before 30 March of the following year. AG has 6 months to do the audits.

48. The financial reports compare actual expenditure with budgeted and programed allocations. Variance analysis is undertaken for proper implementation of budgetary control system at the RSC level.

49. Presently the financial reporting system has no link with the financial information systems of individual project progress. This lack of financial controls to reduce the risk that the physical and financial project progress data may not always synchronize with the reported financial data is a limitation of the financial reporting system.

50. **Information systems.** Accounting division of NWSDB uses customized computerized accounting systems. It fulfills the present needs of NWSDB. It is a standalone system where the salaries and collections run on different systems.

E. Risk Assessments

51. The FMA has considered two types of risks, (i) inherent risks, i.e., risks outside the direct control of the entity financial management; and (ii) control risks, i.e., risks concerning the internal functioning and control of the entity's accounts division. The following key risks have been identified.

Table 1: Financial Management Inherent and Control Risk Assessment

Risk Type	Risk Assessment	Proposed Mitigation Measures
A. Inherent Risk		
1. Country – Specific Risks (Sri Lanka)	<p>Moderate</p> <p>a. Low institutional capacity for effective financial management; and</p> <p>b. Lack of complete information for accurate budgeting and manual process in public financial management.</p>	<p>a. Ongoing efforts are underway by government and ADB. Provision of support (both loan and TA) focused on capacity development; and</p> <p>b. Provision of loan support for IT systems and ensure that the systems are up and running smoothly.</p>
2. Entity – Specific Risks (NWSDB)	<p>Substantial</p> <p>a. Planned tariff increases of 30% in 2016 have not been endorsed by the government so far. If the proposed tariff increase does not take place, the medium and long-term financial sustainability of NWSDB may be hampered.</p>	<p>a. Continued policy dialogue with NWSDB and the government for approval of regular tariff adjustment and establishment of independent regulatory on water tariffs, together with the sharing of examples of good practice from other countries; and</p> <p>b. In addition, the preparation of financial projections to identify realistic and appropriate tariff increase recommendations.</p>
3. Project – Specific Risks	<p>Moderate</p> <p>a. The NWSDB do not have adequate financial and technical capacity for the O&M of the desalination plant.</p>	<p>a. Commitment of the O&M budget allocation needs to be confirmed upfront. Capacity development and training programs will be</p>

Risk Type	Risk Assessment	Proposed Mitigation Measures
		implemented under the current and proposed project.
Overall Inherent Risk	Moderate While entity specific risks exist, these risks might be mitigated through cordial efforts of NWSDB and the government with support of ADB. In the case of tariff revisions, the government needs to support NWSDB in achieving tariff increase by 30% every three years as proposed, for improving its financial sustainability.	
B. Control Risk		
1. Implementing Entity	Low a. PMCIU will be responsible for the implementation of the additional financing; and b. NWSDB has handled several projects through a PMCIU. PMCIU (JKWSP) is under the entity and due to centralized control; decisions may take time for implementation.	a. Not applicable.
2. Flow of funds and Budget Allocation	Moderate a. Due to non-availability of allocation in the national budget for the project, it may affect the withdrawal / payments of PMCIU from their imprest account.	a. Action must be taken to obtain fresh allocation for 2017 for the project from MOF; and b. A committee should be appointed which meets once every quarter to transfer amounts from unutilized items to other items which will give more flexibility in using funds.
3. Staffing	Moderate (entity) a. While all the officers are transferable after serving 5 years at any one office, there is no formal procedure in place for regular rotation of duties of staff within the accounts division of the entity. Low (PMCIU) b. No staff vacancies in the PMCIU.	a. Rotation of staff to be implemented to the extent feasible. As staff will gain knowledge on all subjects which can increase the efficiency while improving monitoring and financial control; and b. Not Applicable.
4. Accounting Policies & Procedures	Low a. The NWSDB and its PMCIU follow the Sri Lanka Accounting Standards which are consistent with the International Standards.	a. Not Applicable.
5. Internal Audit	Moderate a. The entity-level internal audit division carries out the internal audit functions of PMCIU; and b. There have been some delays in auditing reports due to vacancies in the audit division.	a. The vacancies in the audit division was filled up.

Risk Type	Risk Assessment	Proposed Mitigation Measures
6. External Audit	<p>Moderate (entity)</p> <p>a. Accounting deficiencies pointed out in audit reports 2011 to 2013 have an impact on accuracy of the future accounts. The deficiencies include: (i) items of completed works not capitalized; (ii) update and reconciliation after the verification of inventory items; (iii) non-reconciliation with the control accounts; and (iv) amounts allocated in the budgets should be more realistic.</p> <p>Low (PMCIU)</p> <p>b. Accounts submitted on due dates and received audit reports on due dates.</p>	<p>a. Responsibility of the audit committee should be expanded to include follow up action on audit queries; and</p> <p>b. The actions to be taken include: (i) system to be developed to issue a completion certificate by the respective project to finance division to transfer the items from work in progress account to asset account; (ii) officer should be assigned to each RSC to deal with the follow up action on the outcome of the verification to update the inventory records and inform the accounts division to update its records; (iii) appoint a team of officers to carry out activities of reconciliation of individual accounts with the control accounts; and (iv) Put in place a budgeting process that employs more robust cost estimation procedures; and</p> <p>c. Not Applicable.</p>
7. Reporting and Monitoring	<p>Low (entity)</p> <p>a. Information produced by the automated system of NWSDB may not fulfill the needs of the ADB. But, the outputs can be used to fulfill the needs of the ADB by use of excel. At the same time, it will not show any physical progress which is essential for monitoring.</p> <p>Low (PMCIU)</p> <p>b. System developed produces the reporting.</p>	<p>a. The information available from reports generated by the system can be used to build up various reports which can easily be used for monitoring.</p> <p>b. The system development for PMCIU includes the requirements of the government and ADB and avoids the delays.</p>
8. Information systems	<p>Low (entity)</p> <p>a. System in operation suits the entity requirement. Back up procedure is in operation but no</p>	<p>a. Suitable procedure needs to be developed to obtain protection cover for the back-ups.</p>

Risk Type	Risk Assessment	Proposed Mitigation Measures
	<p>protection cover obtained on the back-ups.</p> <p>Moderate (PMCIU)</p> <p>b. System itself produces the back-ups; and</p> <p>c. The financial reporting system has no link with the financial information systems of individual project progress.</p>	<p>b. Not applicable; and</p> <p>c. Strengthen accounting unit on system modification process with the support of PMC.</p>
Overall Control Risk	<p>Moderate</p> <p>Some financial management risks are recognized but all of them are not high. Inadequate staff in the accounts division and the internal audit division are found with substantial risks, but this can be tackled with adequate experienced additional staff.</p>	

NWSDB = National Water Supply and Drainage Board, O&M = operation and maintenance, PMC= Project management consultants, PMCIU=Project management, coordination and implementation unit, TA = technical assistance.

F. Strengths and Weaknesses

52. **Strengths.** A significant strength of the financial management systems of NWSDB and its PMCIU is that they have sufficient experience in handling multilateral funded projects including the current JKWSSP funded by ADB. The project accountant in PMCIU is well qualified with a degree in accounting and many years of project accounting experience including more than 5 years of continuously working on the current JKWSSP.

53. **Weaknesses.** The significant weaknesses of the financial management system are as follows;

Significant weakness	Resolution
Inadequate staff in the internal audit division of NWSDB.	Strengthening the internal audit division of NWSDB by appointing and recruiting qualified staff to fill the existing vacancies.
Inadequate revisions in water tariffs.	Continuing policy dialogue with the government and NWSDB for approval of regular tariff adjustment and establishment of independent regulatory on water tariffs.
Lack of experience and qualifications of the accounting staff.	Extending full training and capacity building support for strengthening the accounting staff of NWSDB.
No link of the financial reporting system with the financial information systems of individual project progress.	Update and modification of the accounting system with the support of PMCs.

G. Proposed Time Bound Action Plan

54. Following actions agreed noted as an action plan to address issues that the financial management assessment identified in the PMCIU.

Area	Current scenario	Mitigation measures	Target date
Internal audit	About 15% vacancies in the internal audit division of NWSDB which will affect the quality and delay in submission of auditing reports.	Strengthening the internal audit division of NWSDB by appointing and recruiting qualified staff to fill the existing vacancies.	Dec. 2018
Tariff revision	Inadequate revisions in water tariffs which will hamper the medium and long-term financial sustainability of NWSDB.	Continuing policy dialogue with the government and NWSDB for approval of regular tariff adjustment and establishment of independent regulatory on water tariffs.	Dec. 2020
Accounting staff	Lack of experience and qualifications of the accounting staff which will affect the quality and delay in submission of accounting and financial reports.	Extending full training and capacity building support for strengthening the accounting staff of NWSDB.	Dec. 2018
Accounting system	No link of the financial reporting system with the financial information systems of individual project progress which will cause the delays in submission of accounting and financial reports.	Updating and modifying the current accounting system with the support of PMCs.	Dec. 2018

55. **Financial Covenants.** The audited project financial statements prepared in accordance with Sri Lanka Government Accounting Standards will be submitted in the English language to ADB within 6 months of the end of the fiscal year by the implementing agency. A management letter shall also be provided indicating any weaknesses in the internal control system that have come to the auditors' attention as the result of their audit, as well as recommendations for improvement and PMCIU's comments. This shall also include a status update on the follow-up on previous year's audit observations. The Government of Sri Lanka and the executing agency have been made aware of ADB's policy on delayed submission, and the requirements for satisfactory and acceptable quality of the audited accounts. ADB reserves the right to commission an independent audit if the audit is substantially delayed or to confirm that the share of ADB's financing is used in accordance with ADB's policies and procedures. The audited program financial statements shall be disclosed in the ADB and the project website in accordance with ADB's Public Communications Policy (2011).

56. This includes the audit opinion, the program financial statements and accompanying notes. Management letter shall not be disclosed.