

Jaffna Kilinochchi Water Supply and Sanitation Project - 2017

The audit of financial statements of the Jaffna Kilinochchi Water Supply and Sanitation Project for the year ended 31 December 2017 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 4.05 of Article IV of the Loan Agreement No.2710-SRI (Ordinary Operations) and Section 4.03 of Article IV of the Loan Agreement No.2711-SRI (SF) (Special Operations) dated 08 February 2011 entered between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreements of the Project, then Ministry of Water Supply and Drainage, presently the Ministry of City Planning and Water Supply is the Executing Agency and the National Water Supply and Drainage Board, Provincial Irrigation Department of Northern Province and Local Authorities in the Northern Province are the Implementing Agencies of the Project. The objectives of the Project are to improve water supply and sanitation infrastructure for residents living in the areas of the Project and to protect and manage the water resources of the Jaffna Peninsula. As per the Loan Agreements, the total estimated cost of the Project under the components implemented by the National Water Supply and Drainage Board amounted to US\$ 147.45 million equivalent to Rs. 16,474.59 million. Out of that US\$ 76.45 million equivalent to Rs.8,541.76 million was agreed to provide by the Asian Development Bank and US\$ 48 million equivalent to Rs.5,363.04 million was agreed to provide by the Agence Francaise De Development. The balance of US\$ 23 million equivalent to Rs.2,569.79 million required to be contributed by the Government of Sri Lanka. The Project commenced its activities on 15 February 2011 and scheduled to be completed by 14 August 2017. Subsequently, period of the Project had been extended up to 31 December 2020.

1.3 Responsibility of the Management 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.

1.4 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of

the financial statements 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 the Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loans, etc.
- (d) Whether the opening and closing balances, withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreements.
- (f) Whether the funds, materials and equipment supplied under the Loans had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (i) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) Whether the financial covenants laid down in the Loan Agreements had been complied with.

1.5 Basis for Qualified Audit Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2017 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2017 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances, withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) the Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreements,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreements had been complied with.

2.2 Comments on Financial Statements

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2.2.1 Accounting Deficiency

The following observations are made.

- (a) Interest and commitment charges recovered by the Lending Agency up to 31 December 2017 amounting to Rs.131.04 million and Rs.20.77 million respectively had not been brought to the financial statements.
- (b) As required by the Gratuity Act No. 12 of 1983, provision for gratuity had not been made by the Project for the employees deployed by the Project on contract basis.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2017 are shown below.

Source	Amount agreed for financing according to the Loan Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
ADB	76.45	8,541.76	1,670.30	10.96	1,670.26	28.55	4,100.87
AFD	48.00	5,363.04	-	-	-	0.96	124.64
GOSL	23.00	2,569.79	69.80	0.46	69.75	4.76	666.36
Total	<u>147.45</u>	<u>16,474.59</u>	<u>1,740.10</u>	<u>11.42</u>	<u>1,740.01</u>	<u>34.27</u>	<u>4,891.87</u>

The following observations are made in this regard.

- (a) Out of the total allocation of US\$ 147.45 million equivalent to Rs.16,474.59 million, only US\$ 34.27 million equivalent to Rs.4,891.87 million had been utilized upto 31 December 2017, after lapse of 06 years and 10 months from the date of commencement of the activities of the Project.
- (b) A separate Loan Agreement had been signed by the Agence Francaise De Development with the Government of Sri Lanka on 31 December 2011 to provide US\$ 48 million equivalent to Rs.5,363.04 million for the construction of new Water Intake Lift Station, Treatment Plants, Pumping Station at Iranamadu Tank and supplying and laying of raw and Treated Water Transmission Main to the Jaffna Municipality area. However, the activities of the Project had been suspended and the Loan had been cancelled on 06 October 2015.

3.2 Physical Progress

As mentioned in the paragraph 3.1 (b) above, the activities of the Project had been suspended, due to strong protest of the communities living in the Iranamadu area using Iranamadu Tank as a main source of water for Jaffna Peninsula. However, the Cabinet of Ministers had decided at the meeting held on 15 July 2015 to transform the activities of the Project to desalinate sea water to fulfill the water requirement of people living in the Jaffna Peninsula. Therefore, new Loan Agreements No. 3603 SRI and 3604 SRI had been entered by the Government of Sri Lanka with Asian Development Bank on 15 December 2017. According to the progress reports furnished by the Project, the overall physical progress of the activities of the Project at the end of the year under review had remained at 24.91 per cent.

3.3 Contract Administration

The contract for the supply and laying of Treated Water Transmission Main- Part 01 had been awarded in 2016 at an estimated cost of Rs. 2,646 million and scheduled to be completed in July 2018. However, the contractor had completed the pipe laying works of 24.7 kilometres only, out of the estimated length of 42.8 kilometres required to be completed as at 31 December 2017. Further, the pressure testing works of 11 kilometres had only been completed. The pipe laying works of 107.76 kilometres had been completed under the contract for the supply and laying of Treated Water Transmission Main- Part 02 awarded in 2016 at estimated cost Rs.2,890 million and scheduled to be completed in July 2018, out of estimated length of 144 kilometres of pipe laying works to be completed. Further, the pressure testing works of 46.15 kilometres had been completed as at 15 June 2018.

3.4 Matters in Contentious Nature

A sum Rs.3.45 million had been paid on 11 June 2014 to the National Housing Development Authority to acquire lands to the construction of Nawathkuliya Water Tower and office building. However, the ownership of the lands acquired had not been transferred to the National Water Supply and Drainage Board even as at 31 December 2017.

3.5 Issues on Financial Controls

The transactions of the Project during the year under review was not subjected to internal audit as per the Financial Regulation 133 and recruit an Internal Auditor as required by the Management Audit Circular No. 02/2016 of 10 June 2016.