

Jaffna Kilinochchi Water Supply and Sanitation Project - 2015

The audit of financial statements of the Jaffna Kilinochchi Water Supply and Sanitation Project for the year ended 31 December 2015 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) of 08 February 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank.

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 and the Provincial Irrigation Department through the Northern Provincial Council under the Ministry of Provincial Councils and Local Government 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 Project area and protect and manage Jaffna Peninsula water resources. The Project shall comprise (a) improving water supply and sanitation infrastructure (b) strengthening Jaffna water resource management and (c) construction of Jaffna Regional Office to enhance implementation capacity. 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\$ 147.32 million equivalent to Rs.16,460.07 million. Out of that US\$ 76.45 million equivalent to Rs.8,541.76 million or 52 per cent was agreed be provided by the Asian Development Bank and US\$ 48 million equivalent to Rs.5,363.04 million or 33 per cent was agreed to be provided by the Agence Francaise de Development. The balance of US\$ 22.87 million equivalent to Rs. 2,555.27 million or 15 per cent was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 15 February 2011 and scheduled to be completed by 14 February 2017.

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 judgement, 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 Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreements.
- (e) Whether the opening and closing balances and withdrawals from and replenishments to the Imprest Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (f) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreements.
- (g) Whether the funds, materials and equipments supplied under the Loans had been utilized for the purposes of the Project.
- (h) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (i) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.

- (j) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and
- (k) 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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 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 and withdrawals from and replenishments to the Imprest Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,
- (d) the Statements of Expenditure (SOEs) 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

2.2.1 Accounting Deficiency

Commitment charges amounting to Rs. 57.8 million recovered by the Agence Francaise de Development (AFD) up to 31 December 2015 had not been brought to account. Further, interest of US\$ 116,938.65 recovered by the Asian Development Bank under the Loan 2710 SRI and 2711 SRI (SF) had also not been brought to the financial statements.

2.2.2 Un-reconciled Balances

The following observations are made.

- (a) According to the financial statements of the National Water Supply and Drainage Board, the work-in-progress of the activities carried out by the Project as at 31 December 2015 amounted to Rs. 1,084.1 million. However, according to the financial statements of the Project, it was shown as Rs.1,347.8 million. The difference of Rs.263.7 million had not been reconciled.
- (b) As per the information furnished by the Ministry of City Planning and Water Supply, total expenditure of the Project under this Project as at 31 December 2015 amounted to Rs. 491 million. However, the cost of the Project shown in the financial statements of the Project amounted to Rs. 424 million. The difference of Rs. 67 million had not been reconciled and adjusted in the financial statements accordingly.
- (c) According to the information received, a sum of Rs. 136.3 million released by the National Water Supply and Drainage Board during the year under review to implement the activities of the Project was not agreed with corresponding amount of Rs.88.9 million shown in the financial statements of the Project. It was observed that the remuneration amounting to Rs.48.6 million paid to the employees of the Project had been deducted by the Board from the remittance received by the Lending Agency as well as contribution of the Government of Sri Lanka and that was the main reason for the above mentioned difference.

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 2015 are shown below.

Source	Amount agreed for financing in the Loan Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilized			
				during the year 2015		up to 31 December 2015	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	76.45	8,541.76	1,437.00	2.96	402.70	9.25	1,172.60
AFD	48.00	5,363.04	30.00	0.16	21.30	0.98	124.64
GOSL	22.87	2,555.27	500.00	0.59	80.84	2.36	299.38
	<u>147.32</u>	<u>16,460.07</u>	<u>1,967.00</u>	<u>3.71</u>	<u>504.84</u>	<u>12.59</u>	<u>1,596.62</u>

The following observations are made in this regard.

- (a) The activities of the Project had been suspended due to the strong resistance from farmers in the Iranamadu area on sharing water resource. As a result, US\$ 12.59 million equivalent to Rs 1,596.62 million, out of the total allocation of US\$ 147.32 million equivalent to Rs 16,460.07 million had only been utilized as at 31 December 2015 after lapse of 04 years and 10 months from the commencement of the activities of the Project.
- (b) A separate Loan Agreement had been entered into by the Government of Sri Lanka with the Agence Francaise de Development to provide US\$ 48 million equivalent of 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. Out of that, the Project had utilized a sum of Rs. 124.64 million or 2.3 per cent at the end of the year. However, the Loan had been cancelled in 06 October 2015 due to abandonment of the activities of the Project. As a result, a compensation of Rs. 11.90 million and appraisal fees of Rs. 15.2 million had been paid by the Project, in addition to the commitment charges of Rs. 57.80 million paid on underutilization of funds from 2012 to 2015.

3.2 Physical Progress

The following observations are made.

- (a) As mentioned in the paragraph 3.1 (a) above, the activities of the Project was abandoned due to strong protests of the communities living in the Iranamadu area for the use of Iranamadu Tank as a main source of water for Jaffna Peninsula. However, the Cabinet of Ministers had decided at its meeting held on 15 July 2015 to transform the activities of the Project to desalt sea water to fulfill the water requirement of the

Jaffna Peninsula. However, the plans for the changes of the scope of the works and cost estimation thereon had not been prepared even as at 31 December 2015.

- (b) According to the information received, the sources of ground water in the Jaffna Peninsula was heavily contaminated due to improper sewerage disposal and underneath sand and limestone layer which opened to pollute easily. Having understood the necessity of preservation of water as there was no conventional sewerage collection and disposal system, US\$ 35.64 million equivalent to Rs. 3,982 million had been allocated by the Project for the purpose of improvement of sewerage and sanitation systems in the Peninsula including construction of a building of a sewerage collection system, sewerage treatment plant, an effluent sea outfall and providing maintenance equipment.

The following observations are made in this connection.

- (i) According to the progress report of the Project, the designing works and bidding process for the contribution of sewerage treatment plants and sewerage reticulation had been completed as at 31 December 2015. However, such construction works had been suspended subsequently in 2016. Therefore, the information collected through household and topographic surveys conducted in this connection in 2015 at a cost of Rs. 24.30 million would not be used for intended purposes.
- (ii) The works related to laying of pipes across the main road and construction works of office buildings had only been completed as at 31 December 2015 at a cost of Rs. 266.6 million, out of other 30 works which included in the procurement plan of the Project and expected to be completed during the year under review.