

## **Jaffna Kilinochchi Water Supply and Sanitation Project - 2016**

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The audit of financial statements of the Jaffna Kilinochchi Water Supply and Sanitation Project for the year ended 31 December 2016 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 was agreed be provided by the Asian Development Bank and US\$ 48 million equivalent to Rs.5,363.04 million 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 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 August 2017. Subsequently, the period of the Project had been extended up to 14 May 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 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka 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. 19.4 million recovered by the Asian Development Bank under the Loan No. 2710 SRI up to 31 December 2016 had not been brought to the financial statements. Further, interest charges amounting to Rs. 54.5 million recovered up to 31 December 2016 by the Lending Agency had also not been brought to account as an expenditure of the Project. According to the State Account Circular No. 230/2013 of 29 November 2013 of the Ministry of Finance and Planning, the interest and other charges incurred during the construction period required to be capitalized.

### **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 2016 amounted to Rs. 2,023 million. However, according to the financial statements of the Project, it was shown as Rs. 2,236 million. The difference of Rs. 213 million had not been reconciled.

- (b) According to the financial statements, a sum of Rs. 505.98 million had been claimed through 12 withdrawal applications as at 31 December 2016. However, according to the records maintained by the Department of External Resources, a sum of Rs. 536.73 million had been claimed. The reasons for difference of Rs. 30.75 million had not been explained.
- (c) According the financial statements, the lands in Kilinochchi area had been acquired by the Project at a cost of Rs. 16.45 million during the year under review. However, according to the information made available at the Project Implementing Office at Killinochchi, the cost of the lands acquired amounted to Rs. 13.91 million.

### 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 2016 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			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
ADB	76.45	8,541.76	1,235.00	8.50	1,236.43	18.55	2,409.06
AFD	48.00	5,363.04	-	-	-	0.98	124.64
GOSL	22.87	2,555.27	325.00	2.20	321.04	4.76	618.19
	<b><u>147.32</u></b>	<b><u>16,460.07</u></b>	<b><u>1,560.00</u></b>	<b><u>10.70</u></b>	<b><u>1,557.47</u></b>	<b><u>24.29</u></b>	<b><u>3,151.89</u></b>

The following observations are made.

- (a) The activities of the Project had been suspended due to the strong resistance from farmers in Iranamadu area on sharing water resources. As a result, US\$ 24.29 million equivalent to Rs. 3,151.89 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 2016 after lapse of 05 years and 10 months from the commencement of the activities of the Project.
- (b) The Loan Agreement entered into 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 plant, pumping station at Iranamadu Tank and supplying and laying of raw and treated water transmission main to the Jaffna Municipality area had been terminated in 06 October 2015 due to abandonment of

the activities of the Project. The Project had utilized a sum of Rs. 124.64 million representing 2.3 per cent of the allocation and as a result, a compensation amounting to Rs. 11.90 million and appraisal fee of Rs. 15.2 million had to be paid.

### **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 2016.
- (b) The works related to the improvement of sewerage and sanitation systems in the Jaffna Peninsula including construction of a building of a sewerage collection system, sewerage treatment plant, an effluent sea outfall and providing maintenance equipment had been commenced in 2015 under the allocation of US\$ 35.64 million equivalent to Rs. 3,982 million made under the Agreement entered into with Agence Francaise de Development in order to preserve water in the Peninsula. However, such construction works had been suspended during the year under review as the Loan Agreement thereon had been terminated.

### **3.3 Contract Administration**

The contracts for the construction of elevated water towers under Package 01 and 02 had been awarded in 2014 at estimated cost of Rs. 525 million and Rs. 614 million respectively. According to the construction plan, activities of the contract should be completed on 17 August 2016. However, slow physical progress of the both contracts was remained at 50 per cent as at 31 December 2016 due to delays in conducting geological investigations within scheduled time period and delays in submission of construction drawings.

### **3.4 Issues on Financial Control**

The transactions of the Project during the year under review was not subjected to audit of the Internal Audit Section of the National Water Supply and Drainage Board, as per the Financial Regulation 134 (3) and Management Audit Circular No. 05 of 26 July 2010 of the Department of Management Services.