

Jaffna and Kilinochchi Water Supply and Sanitation Project - 2022

The audit of financial statements of the Jaffna and Kilinochchi Water Supply and Sanitation 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 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 and Section 4.03 of Article IV of the Loan Agreement No. 3603-SRI and No. 3604-SRI(Additional financing) dated 15 December 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. 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, the Ministry of Water Supply and Drainage, presently the Ministry of Water Supply and Estate Infrastructure Development is the Executing Agency and National Water Supply and Drainage Board, Provincial Irrigation Department of Northern Province and Local Authorities in the Northern Province are the Implementing Agency 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. The activities of the Project are implemented under 03 components namely Improving Water Supply and Sanitation Infrastructure, Strengthening Jaffna Water Resource Management and Building Capacity of NWSDB. 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 equivalents to Rs 2,569.79 million required to be contributed by the Government of Sri Lanka. However, Loan from Agence Francaise De Development had been cancelled on 06 October 2015 due to some activities of the Project had been suspended, because of the restructuring the Project scope as water source from Irranamadu tank to a Desalination Plant. Therefore, additional loan agreement had been entered by Government of Sri Lanka with Asian Development Bank on 15 December 2017. As per the Additional Loan Agreements, the total estimated cost for activity of the Project amounted to US\$ 153 million equivalents to Rs. 23,256 million. Out of that US\$ 120 million equivalents to Rs. 18,240 million was agreed to provide by the Asian Development Bank. The balance of US\$ 33 million equivalent to Rs. 5,016 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 30 June 2026.

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 this 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 is 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 Deficiencies	Response of the Management	Auditor's Recommendations
(a)	According to the financial statements presented by the project for the year under review, the foreign loan balance amounting Rs. 19,412 million had been shown as at the end of the year under review. The parity adjustment amounting to Rs. 15,544 million have to be done for the above loan balances as at 31 December 2022 as per the Sri Lanka Accounting Standard 21. However as per the Cabinet Paper No. AMP/16/0158/719/005 dated 04 February 2016, 75 percent of the above loan amount could be considered as grant, Therefore the parity adjustment amounting to Rs. 3,886 million for the balance 25 percent of the loan should be done. However, it had not been adjusted in the financial statement.	The Project will certainly take prompt action to comply with Sri Lanka Accounting Standard-LKAS 21 in future.	Should be comply with accounting standards.
2.1.2	Total input VAT amounting to Rs. 23.7 million had been paid and accounted as Work in Progress, regarding the constructions implemented in the years from 2016 to 2022. This amount had been erroneously credited and debited to Work in Progress and receivables accounts respectively in the year under review. Accordingly, the value of Work in progress and receivables had been understated and overstated by the same amount respectively.	Kindly note that the Project sought guidance from the Finance Division in connection with accounting treatment for the input VAT claims. The Finance Division has advised to adjust the input VAT claims in the Project General Ledger	Correct value of working progress should be mentioned in the Financial statements by revising this incorrect entry.

3. Physical Performance

3.1 Physical progress of the activities of the Project

No	Project component	Audit issue	Management Response	Auditor's Recommendations
(a)	Sea water Reverse Osmosis Desalination Plant	Design, build and Operational Contract was awarded and the agreement was signed by February 2021 for Rs. 14,559 million. Design work commenced on March 2021 and the project was expected to be completed by September 2023. The operation Period has planned to go until September 2030. Although 83	The Contract was delayed due to various reasons. The Contractor has requested EOT up to May 2024 and Present physical progress of SWRO is 62.18%, the Project (PMCIU) is closely monitoring to complete said works	Expedite action should be taken to complete the scheduled components.

percent physical progress was expected to be achieved at the end of the year under review, the actual physical progress was 49 percent as at 31 December 2022.

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| (b) | Laying of water distribution network in Jaffna City area. | Value of this contract was Rs. 3,160 million and needed to complete in January 2023 and 95 percent progress was expected by the end of the year 2022. However, actual physical progress was 56 percent. | The Project is closely monitoring to get relevant authorities to get approval for additional amount to complete the balance works according to scope of contract and with contractor to complete the works | Expedite action should be taken to complete this component of the project. |
| (c) | Mechanical, Electrical and SCADA package | Although bid was published on October 2021 and bidding process was completed on March 2022, Financial evaluation process had not been completed even as at 31 December 2022. | SCAPC meeting held on 15.5.2023 to recommend for the awarding. PMCIU is closely monitoring to complete the project. | Expedite action should be taken to complete the component. |

3.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Refundable Deposit Rs. 72.6 million which was given to the Road Development Authority for the laying of pipes had not been settled, even it has passed 5 years after completion of the work and performance bond of Rs.45 million issued to the Road Development Authority for the laying of pipes in the DN 02 water distribution pipeline system had expired on 3 December 2022. The action had not been taken to withdraw the deposited money which relevant to the bond.	PMCIU is taking necessary action with RDA in order to reimburse the deposits from RDA	Action should be taken to settle the Deposits
(b)	According to the sample audit inspection it was observed that in 09 variations payments the value of Rs.140,002,634 had been paid to the contractors without prior approvals.	Once the amount is finalized with the Contractor only VO Committee shall be signed in the VO approval sheet. It may differ from the payment date.	Should be complied with the rules and regulations.
(c)	The project was planned to provide safe drinking water to 300,000 families living in Jaffna and Kilinochchi districts of the Northern Province and to improve sanitation infrastructure to 80,000 families. Due to Project scope had been changed time to time	NWSDB taking necessary action to seeking funds to implement the sewerage project.	Action should be taken to fulfill the objective of beneficiaries of this project

and action had taken to restructure the Project removing sewerage network and sewage treatment plant from the Project scope. Therefore, expected performance could not be achieved and beneficiaries of this Project had been lost outcome of the Project.

(d) **Sea water Reverse Osmosis Desalination Plant**

- (i) Design, build and Operate Contract was awarded 25 January 2021 for Rs.14, 559 million and agreement was signed on 23 February 2021. The contract should be completed by September 2023, including 910 days for design and construction and 2,555 days for operational services. As at 31 December 2022, expected physical progress was 83 percent, but the actual physical progress was 49.5 percent, therefore it was observed that the construction work was not done within the contract time frames as planned. And Rs. 4,799.6 million had been paid to the contractor and financial progress was 33 percent on this task as at 31 December 2022.
- (ii) The offshore works of the sea water intake pipeline for the steam and the residual water discharge pipeline after treatment which are relevant to the SWRO unit, were planned to start on 15 February 2023, but the related activities had not been started by February 2023.
- (iii) As per the contract agreement, operation and maintenance cost of SWRO plant was Rs. 3,693,604,285 and the operation and maintenance period scheduled to start from 2024 to 2030. According to the additional loan agreement, the loan period ends on 30 June 2026, therefore it was observed that under the existing conditions, the operation and maintenance costs can be covered only for a period of 03 years within the loan period. As a result, a big amount of operation and maintenance cost should have to be found for the period which not covered by the initial loan agreement, further it was observed that there is a risk of sustainability on operation of the unit.
- The Contract was delayed due to various reasons Present physical progress of SWRO is 62.18%, the Project (PMCIU) is closely monitoring to complete said works. The Project (PMCIU) is closely monitoring to complete said works .During the signing of the additional loan in 2017 it was included the operation period also within the closing date of loan period. But due to the delay in awarding of contract of SWRO, the operation period also shall be delayed, therefore, PMCIU will take action to extend the loan closing date to cover up the operation service period. The most of the delay is beyond the NWSDB control, however the NWSDB is closing monitoring to catch-up the delay to complete the works.
- Expedite action should be taken to complete the component.

(iv) Although the invitation of bids for the construction of SWRO Plant was made on 07 December 2016, the awarding of the contract was on 25 January 2022, Hence it has taken five years for the procurement process.

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| (e) | It was observed that the installation of Electrical and Mechanical equipment and SCADA system should be completed in order to make the Project operation. However, expedite action had not been taken to complete the procurement process and complete the contract promptly. | There was a procurement process delay and it shall be awarded once obtained the SCAPC Minutes, ADB's Concurrence, Appeal process clearance, Cabinet and Board approval. | Expedite action should be taken to complete the procurement process |
| (f) | A Contract of Laying of water distribution network in Jaffna City area valued at Rs. 3,160.20 million had been awarded to a contractor on January 2021. Although Contract should be completed by January 2023, only 140 kilometers had been completed out of 264 kilometers as at 31 December 2022. | The Project is closely monitoring to get relevant authorities to get approval for additional amount to complete the balance works according to scope of contract and with contractor to complete the works. | Expedite action should be taken to complete the component. |
| (g) | It was revealed that Project had been utilized only 46 percent of funds under imprest fund account no 3604 during the year under review and amounting Rs.69,087,080 had been paid as interest up to 31 December 2022 | The Line Ministry, NWSDB and PMCIU are closely monitoring the progress to complete the project without further delay. | Action should be taken to utilized fund without delay. |

3.3 Underutilized Resources

Audit Issue	Response of the Management	Auditor's Recommendation
Even though the Commitment Charges are unavoidable with this economic crisis of the country, it could be minimized by achieving disbursement targets. However, the general treasury had paid Rs. 464.8 million as commitment charges on undisbursed loan balance from 2016 to 2022 regarding this project.	Mainly, restructuring the project scope (From conventional treatment to SWRO Treatment) was affected the project progress significantly. Contracts delayed due to the reasons such as Covid-19, Easter attack, Adverse weather conditions, country economic crises and Import restrictions by Government.	Executing agency should discuss with lender to reduce commitment charges, due to current economic situation.