

Supporting Electricity Supply Reliability Improvement Project – 2022

The audit of financial statements of the Supporting Electricity Supply Reliability Improvement 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 2.09 of Article II of the Grant Agreement No. 0486-SRI dated 19 December 2016 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 Grant Agreement, the Ministry of Power and Energy is the Executing Agency and Lanka Electricity Company (Private) Limited is the Implementing Agency of the Project.

The objectives of the Project are to support the establishment of hybrid renewable energy systems through the construction of a renewable energy micro-grid system in the Western province. The activities of the Project are implemented under component namely establishment of renewable energy micro grid system. As per the Grant Agreement, the estimated total cost of the Project was US\$ 1.8 million equivalent to Rs.268.36 million and entire amount agreed to be financed by Asian Development Bank. The Project had commenced its activities on 29 June 2017 and scheduled to be completed by 30 September 2021. However, the date of completion of the activities of the Project had been extended up to 30 September 2022.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2022, statement of expenditure and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for 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 my 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 skepticism 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 Non Compliance with Laws, Rules and Regulations

| No. | Reference to the Laws Rules and Regulations | Non Compliance/Audit Issue | Response of the Management | Auditor's Recommendations |
|-------|---|--|---|---|
| (a) | Memorandum of Understanding (MOU) between the Lanka Electricity Company (Private) Limited and the University of Moratuwa, | | | |
| (i) | Section 1 | A website where the pilot and research projects and advancements can be published had not been developed. | Once the contract agreement is signed and R&D activities are initiated, a website with the latest developments of the micro grid lab will be published. | Action need to be taken as per the MOU provisions. |
| (ii) | Section 3.1 | Even though the project was fully completed by 31 December 2022, Smart Grid Development Fund had not been established. | Currently, the UOM has signed and provided an agreement, which is currently undergoing technical review by LECO and expects to sign and establish it soon. Once the contract agreement is signed, the R&D fund will be established. | Smart Grid Development Fund should be established as per the provisions of the MOU. |
| (iii) | Section 3.8 | The steering committee meeting had not been conducted in accordance with the MOU. | In absence of the functional contract agreement and action plan for R&D activities, activities of the steering committee were very limited with their primary focus being making decisions | The steering committee should perform as per the MOU provisions. |

regarding project implementation and grant disbursement. Consequently, committee was convened solely to address above specific requirements during the referred period.

(iv) Section 3.10

The committee shall aggregate research proposals for the forthcoming year at the end of each year and prepare a research plan and budget. Even though project was completed as at 31 December 2022, such information had not made available to the Audit.

Once the contract agreement and R&D fund is established to source the research budget, committee will openly advertise to call for research proposals.

Appropriate action should be taken as per the MOU to achieve the objectives of the project.

(v) Section 4.3

LECO shall ensure that both parties (LECO and University of Moratuwa) will not be given any direct or indirect financial benefit of the solar electricity generation. According to the information received to the audit it was observed that 225MWh had been generated from the solar panel and 33MWh had been supplied to National Grid (without Solar Purchasing Agreement) while using energy for activities of lab and suburb university area during the period of May 2022 to 31 December 2022. Hence, it was observed that the benefits from solar electricity generation had been obtained by the

As per the MOU, it is the LECO who should not be benefited from the Solar PV generation of this grant and not the UOM. Currently all the Solar PVs are generating and contributing to the UOM network which reduces their utility electricity usage and excess energy is stored in the battery bank. Whatever the excess energy generated are supplied to the national grid and these exports will be metered once the metering arrangement is established and divert the equivalent

Action should be taken as per the MOU provisions.

University of Moratuwa and Lanka Electricity Company, due to not establishment of Smart Grid Development Fund. monetary value to the fund.

(vi) Section 7

A joint working legal Contract reflecting the MOU shall be signed between the parties not later than 3 months after signing of MOU. Even though the MOU had been signed in October 2018 and project was completed as at 31 December 2022, joint working legal contract has not been signed by parties even up to the end of the year under review. Currently, the UOM has signed and provided an agreement, which is currently undergoing technical review by LECO and expects to sign and establish it soon. Action should be taken as per the MOU provisions.

3. Physical Performance

3.1 Contract Administration

Audit Issue

The selected bidder for designing, construction, installation and commissioning of Renewable Energy Micro grid Pilot Project had not quoted for mandatory spare parts for two years of operation of Micro grid system. However, Technical Evaluation Committee recommended the bid subject to agreeable solution pertaining to above bid item prior to award of contract. Subsequently, the contract had been awarded on 11 February 2020 as contractor had provided two year or more warranties for the other mandatory spare parts quoted.

Response of the Management

This matter was discussed during one of the meetings had with the contractor before awarding the contract. Since they have provided two year or more warranties for the equipment mentioned, it is considered that cost for the spare parts for two years also included with the offer.

Auditor's Recommendation

This matter should be considered along with warranty for the periods agreed by the supplier as the bidder is obliged to supply of mandatory spare parts for the two years operation of micro grid system.

3.2 Observation made on site visits

| Audit Issue | Management Response | Auditor's Recommendations |
|---|---|--|
| In Site visit on 03 May 2023, It was observed that, the Real Time Digital Simulator (RTDS) purchased incurring 183,000 USD on 30 September 2022 under the approved Variation Order II had not been installed. | Given the complexity of the equipment, manufacturer has recommended to unbox and commission the equipment under his supervision. Site visit was carried only on 03rd May 2023 and manufacturer sent an authorized representative from Canada on 08th May, 2023 to unbox and commission the equipment which is now on operation. | Actions need to be taken to install and utilise the machine. |