

Clean Energy and Network Efficiency Improvement Project – 2014

The audit of financial statements of the Clean Energy and Network Efficiency Improvement Project for the year ended 31 December 2014 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 Article 2.09(a) ii of the Loan Agreement No.2892 SRI(SF) and Grant Agreement No. 0303- SRI(EF) dated 08 May 2013 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan and Grant Agreements of the Project, the Ministry of Power and Energy is the Executing Agency and Ceylon Electricity Board is the Implementing Agency for all Parts of the Project whereas Sustainable Energy Authority is the Implementing Agency for Part 7 of the Project. The objectives of the Project are to increase the clean power supply and improve the efficiency and reliability of the delivery of electricity in Sri Lanka. As per the Project Administration Manual, estimated total cost of the Project is US\$ 200 million equivalent to Rs.25,240 million and out of that US\$ 131.5 million equivalent to Rs.16,595 million or 66 per cent was agreed to be provided by the Asian Development Bank. The Project commenced its activities on 30 September 2013 and scheduled to be completed by 31 December 2016.

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 Donor 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 Loan/Grant, etc.
- (d) Whether the withdrawals under the Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements,
- (e) Whether the funds, materials and equipments supplied under the Loan and Grant had been utilized for the purposes of the Project,
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (g) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards,
- (h) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and

- (i) Whether the financial covenants laid down in the Loan and Grant Agreements had been complied with.

1.5 Basis for 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 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Sri Lanka Accounting Standards.
- (b) the funds provided had been utilized for the purposes for which they were provided.
- (c) the Statement of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan and Grant Agreement.
- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) the financial covenants laid down in the Loan and Grant Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) Deposits amounting to Rs. 25.44 million made to the Divisional Secretariat Offices of Homagama and Ambagamuwa Korale for acquisition of two blocks of land for construction of the grid substations at Padukka and Polpitiya had been shown under Work-in-progress.

- (b) Disbursements amounting to Rs.388.30 million made by the Asian Development Bank during the year under review had been shown in the financial statements of the Project as Rs. 212.73 million. The difference was not explained for audit.
- (c) Survey cost of Rs.3.29 million spent during the year under review had been accounted as miscellaneous expenses instead of being capitalized under lands.

2.2.2 Non - Compliance with Laws, Rules and Regulations

Draft financial statements of the Project required to be submitted for audit by 31 March 2015 had been submitted for audit only on 18 June 2015.

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 2014 are shown below.

Source	Amount agreed for financing in the Grant /Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	US\$ million	Rs. million		during the year under review		as at 31 December 2014	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	131.5	16,595.3	2,750.0	1.6	213.0	1.6	213.0
GOSL	68.5	8,644.7	-	-	-	-	-
CEB	-	-	959.0	1.6	210.0	2.0	269.0
Total	<u>200.0</u>	<u>25,240.0</u>	<u>3,709.0</u>	<u>3.2</u>	<u>423.0</u>	<u>3.6</u>	<u>482.0</u>

It was observed that only 1.2 per cent of proceeds allocated under the Loan and Grant had been utilized even after lapse of 50 per cent of the period of the Project as at 31 December 2014. Therefore, the possibility of utilization of entire allocation of proceeds of Loan and Grant during the rest of the period was remained doubtful.

3.2 Physical Progress

The activities of the Project for the purpose of strengthening of the transmission infrastructure and improving of the transmission and distribution network efficiently were expected to be carried out by the Ceylon Electricity Board under 06 Parts. Therefore, the construction and installation of grid substation at Mannar, Polpitiya, Padukka and Kegalle, installation of breaker switch capacitors banks at Biyagama, Kollonnawa and Sapugaskanda and construction and installation of tower lines and gantries at Kabithigollawa , Kahatagasdigiliya, Galaha and Akkarapattuwa were expected to be carried out under the Project. However, the main activities of all parts of the Project had not been commenced during the year under review.

The following observations are made on the physical progress of the Project.

- (a) The land survey activities for grid substation in Mannar under Lot A of Part – 1 of the Project and profile surveying of the transmission line under Lot –B of the same part had been commenced after a delay in 1 ½ years in March 2015.
- (b) All the activities under the Part – 2 of the Project for improving transmission and distribution network efficiency had shown slow progress due to delay in acquisitions of lands and implementation of procurement process.
- (c) The activities under the Padukka Power Transmission Development under the Part -3 and Kegalle Power Transmission Development under the Part-4 of the Project had remained at the initial stages at the end of the year under review by surveying of lands for construction works and installation of transmission line etc.,.

3.3 Issues on Financial Control

Direct responsibility for the entire Project as a single unit had not been assigned to the Ceylon Electricity Board and as a result, ascertaining of financial and physical progress in timely manner and implementation of proper monitoring mechanism by the Ceylon Electricity Board during the period of the operations of the Project was not ensured.