

Sustainable Power Sector Support Project - 2014

The audit of financial statements of the Sustainable Power Sector Support 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 4.05(a) and 4.03(a) of Article IV of the Loan Agreements No.2733 SRI(SF) and No. 2734-SRI(SF) dated 20 June 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, the Ministry of Power and Renewable Energy is the Executing Agency and the Ceylon Electricity Board is the Implementing Agency for Parts 1-6 and 9-10 of the Project whereas the Implementing Agency for Part 7 and 8 shall be the Sustainable Energy Authority. The objectives of the Project are to provide reliable, adequate and affordable power supply expanding coverage and improving efficiency and reliability in service delivering through (i) strengthened transmission system in the Eastern, North Central, Southern and Uva Provinces, (ii) broadened rural electrification in the Eastern and Uva Provinces, (iii) enhanced energy efficiency and further development of renewable energy. As per the Project Administration Manual, the estimated total cost of the Project is US\$ 162.03 million equivalent to Rs. 18,135 million and out of that US\$ 120 million equivalent to Rs.13,427.64 million or 74 per cent was agreed to be provided by the Asian Development Bank. The Project commenced its activities on 17 November 2011 and scheduled to be completed by 30 April 2014. The Loan was expected to be closed on 30 October 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 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, withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) 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,
- (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 equipment 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.

2.1 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 opening and closing balances, withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2014 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 Deficiencies

The following observations are made.

- (a) Motor vehicles procured by the Project at a cost of Rs.68.68 million through the contractors had been shown under work - in- progress instead of being capitalized under the plant, property and equipment.
- (b) Custom duties amounting to Rs.12.56 million paid in 2013 by the Ministry of Power and Renewable Energy on behalf of the Project on 03 Lorries imported under the component of Rural Electrification and Distribution System Improvement had not been capitalized under the plant, property and equipment.

2.2.2 Un-reconciled Balances

It was observed that the proceeds of loans amounting to Rs. 7,531 million and Rs. 678.92 million disbursed during the year under review under the Loan Agreements No.2733 and No. 2734 respectively shown in the financial statements as at 31 December 2014 was not agreed with the corresponding proceeds of Rs.7,607 million and Rs. 877.62 million shown in the records maintained by the External Resource Department of the Ministry of Finance. Action had not been taken to reconcile the differences.

2.2.3 Non - Compliance with Laws, Rules and Regulations

The following instances of non- compliances were observed in audit.

- (a) The financial statements of the Project required to be submitted to the Auditor General on or before 31 March 2014 had been furnished for audit only on 02 July 2015.
- (b) The Project had taken action to reimburse the income taxes amounting to Rs.8.93 million paid by the contractor, contrary to the Section 1.10 of the Loan Agreements.

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 Loan Agreements		Allocation made in the Budget Estimate for the year under review	during the year under review		Funds utilized As at 31 December 2014	
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
ADB	120.00	13,427.64	4,307.00	45.00	4,141.00	69.00	8,210.00
GOSL	42.03	4,707.36	13.00	-	-	-	-
CEB	-	-	429.00	-	259.00	-	1,386.00
	162.03	18,135.00	4,749.00	45.00	4,400.00	69.00	9,596.00

3.2 Physical Performance

According to the information made available, the construction of Grid Substation in Galle and the construction of transmission line from Ambalangoda to Galle under the component of New Galle Power Transmission Development of the Project had shown over 75 per cent of physical progress as at 31 December 2014. However, the activities of augmentation of Kiribathkumbura Grid Substation under the North East Power Transmission Development Project and activities of installing of medium voltage distribution system in Haldummulla and Ragala under the Strengthening of Distribution System in Uva Province had shown slow progress as at 31 December 2014. Further, the procurements for the installation of 40 MV breaker switched capacitor banks for loss reduction at Aniyakanda, Ambalangoda and Katunayake grid substations under the component of Reactive Power Management had not been completed during the year under review. In addition, 03 motor vehicles supplied under the component of Eastern Province Distribution Capacity Development had been subsequently rejected by the Project as such motor vehicles were not agreed with the specifications.

3.3 Management Inefficiency

The activities under the Part 7 and 8 of the Project were not come under the purview of the Additional General Manager (Projects) of the Ceylon Electricity Board who is responsible for all foreign funded projects handled by the Ceylon Electricity Board. As such, overall monitoring of the activities of 08 Parts assigned to the Ceylon Electricity Board had not been properly carried out.

3.4 Un-economic Transaction

Action had not been taken by the Project to recover the 10 per cent of the advance of Rs. 2.05 million and the custom duty amounting to Rs.8.19 million from the contractors on motor vehicles imported and subsequently rejected due to mismatch with the specifications.