

Mahaweli Water Security Investment Programme –Tranche 1 - 2016

The audit of financial statements of the Mahaweli Water Security Investment Programme –Tranche 1 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 Article 4.06 (a) of Loan Agreement No. 3267 – (SRI) and Article 4.03 (a) of Loan Agreement No 3268 (SF) dated 17 September 2015 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Programme

According to the Loan Agreements of the Programme, the Ministry of Mahaweli Development and Environment is the Executing Agency and the Sri Lanka Mahaweli Authority and Department of Irrigation are the Implementing Agencies of the Programme. The objective of the Programme is to secure access to water resources for agricultural and drinking purposes in the Programme area. As per the Loan Agreements, the estimated total cost of the Programme amounted to US\$ 190 million equivalent to Rs.27,740 million and out of that US\$ 150 million equivalent to Rs.21,900 million was agreed to be provided by the Asian Development Bank. The Programme commenced its activities in June 2015 and scheduled to be completed by December 2019.

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 Programme’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 Programme’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 Programme management and the reliability of books, records, etc. relating to the operations of the Programme.

- (b) Whether the expenditure shown in the financial statements of the Programme had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Programme.
- (c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Programme from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Programme in financial and physical terms, the assets and liabilities arising from the operations of the Programme, the identifications of the purchases made out of the Loans, etc.
- (d) Whether the opening and closing balances, withdrawals from and the replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Programme 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) 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 Loans 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 Programme.
- (h) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Programme.
- (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.

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, 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 the 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 the replenishments to the Special (Dollar) 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,
- (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 Non - Compliance with Laws, Rules and Regulations

According to the Circular No DMA/D/2015 of 15 June 2016 of the Secretary of the Ministry of Finance, an Internal Auditor should be recruited for Foreign Funded Projects which exceeds the total estimated cost of US\$ 10 million. Eventhough this Programme which commenced its activities in June 2015 and the expected total cost of US\$ 190 million, action had not been taken to recruit an Internal Auditor enable to establish proper monitoring mechanisms over the activities of the Programme.

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 Credit Agreement		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
Loan No 3267	76.00	11,096.00	970.73	2.90	437.20	2.90	437.20
Loan No 3268	74.00	10,804.00	1,518.33	3.60	526.85	6.20	859.35
GOSL	40.00	5,840.00	560.94	1.70	244.88	2.20	316.42
	<u>190.0</u>	<u>27,740.00</u>	<u>3,050.00</u>	<u>8.20</u>	<u>1,208.93</u>	<u>11.30</u>	<u>1,612.97</u>

According to the information received, the allocation of Rs.7,550 million made for the year under review had been revised as Rs.3,050 million subsequently. Out of that a sum of Rs.1,208.93 million representing 40 per cent of the revised allocation had only been utilized at the end of the year under review.

3.2 Physical Progress

The following observations are made.

- (a) According to the Action Plans of the Programme, it was expected to achieve overall physical target of 19 per cent of works of the Programme at the end of the year under review. However, such physical target had been revised as 12.9 per cent subsequently and the actual achievement of the physical target was remained as 7.59 per cent of works only at the end of the year under review. It was observed that the contracts for several construction works had been awarded with delays and as a result, the expected physical targets stipulated in the Action Plans of the Programme could not be achieved at the end of the year under review. Therefore, the risks on completion of the works on due dates and possibility of cost overrun due to price fluctuations could not be ruled out in audit. The instances observed are given below.
- (i) The expected physical target of 30 per cent to be achieved on construction works of Upper Elahera Canal was not achieved, as a result of the contract awarded with delays on 21 November 2016. Therefore, 3.2 per cent of works had only been completed at the end of the year under review.
- (ii) It was observed that only 2.3 per cent of works had been completed eventhough 20 per cent of works expected to be completed as at 31 December 2016 under the contract for the improvements of 5.25 kilometres of Wemidilla left bank Main Canal up to Nebadagahawatta and construction works of new sluice and tail Canal at an estimated cost of Rs.805.32 million, as a result of awarding of the contract only on 21 November 2016.
- (iii) The rehabilitation works of 30.14 kilometres of Minipe Left Bank canal - Stage - 01 of which 30 per cent of works expected to be completed as at 31 December 2016 had remained behind the targets, as a result of awarding of the contract was made only on 07 September 2016.
- (b) The works relating to the preparation of bid documents had not been completed even end of the year under review on construction works of Mahakithula Inlet Tunnel, Mahakithula and Mahakirula Reservoirs, constructions of main canal of 17.25 kilometres from Nebadagahawatta to Mahakithula Reservoir with feeder canals and the rehabilitation works of 19.76 kilometres of Minipe Left Bank Canal - Stage - 02 and Stage 03, eventhough it was expected to achieve 30 per cent physical targets as at 31 December 2016 under the each contract. Further, the preparation of bid documents were being done at the end of the year under review on contract of the raising of crest of Minipe Anicut and water control and measurement facilities

which 50 per cent of such works expected to be completed as at 31 December 2016.

3.3 Issues on Financial Control

The expenditure incurred by the Programme during the year under review amounting to Rs.1,327.87 million was not agreed with the corresponding expenditure of Rs.1,576.66 million of the Programme shown in the records maintained by the General Treasury. The entries made in the records of the General Treasury on direct expenses amounting to Rs.332.50 million and adjustments made to record the net balance of expenditure amounting Rs.83.71 million incurred by the Programme Monitoring Unit was the main reason for the above mentioned difference.

3.4 Human Resources Management

The following observations are made.

- (a) According to the approved cadre of the Department of Management Service, the staff of the Programme should be comprised with 177 cadre positions and out of that, 71 position including Deputy Project Directors, Project Engineers, Senior Technical Officers had remained vacant for over one year as at 31 December 2016.
- (b) It was observed that 02 Accountants had been recruited by the Project in March 2016 on acting basis and allowances aggregating Rs.1.12 million paid eventhough such posts were not included in the cadre positions approved by the Department of Management Service by its Letter dated 17 June 2016.