

Sustainable Power Sector Support Project (Part 07 and 08) 2016

The audit of financial statements of the Sustainable Power Sector Support Project (Part 07 and 08) 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 Section 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 Part - 01 to Part 06 and Part 09 and 10 of the Project whilst Sri Lanka Sustainable Energy Authority is the Implementing Agency for Part 07 and 08 of the Project. My observations on the activities carried out by the Sri Lanka Sustainable Energy Authority under the Part 07 and 08 of the Project are contained in this report. 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 (a) strengthened transmission system in the Eastern, North Central, Southern and Uva Provinces (b) broadened rural electrification in the Eastern and Uva Provinces and (c) enhanced energy efficiency and further development of renewable energy. As per the Project Administration Manual, the total estimated cost of the Project amounted to US\$ 162.03 million equivalent to Rs. 18,135 million and out of that, US\$ 1.93 million equivalent to Rs. 216.16 million representing 1.19 per cent was agreed to be financed by the Asian Development Bank for the Sri Lanka Sustainable Energy Authority. The Project commenced its activities on 17 November 2011 and scheduled to be completed by 30 April 2014. Subsequently, the period of the Loan had been extended up to 30 October 2016. However, the activities of the Project were continued upto 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 Public Sector 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 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 their overall presentation of the financial statements. I believe that the audit evidence I have obtained sufficient and appropriate to provide a basis for my opinion the examination also included such tests as 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 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether the Statements of Expenditure 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 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 Public Sector Accounting Standards, and
- (j) 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. 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 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 Sri Lanka Public Sector 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 2016 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) the Statements of Expenditure 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 Presentation of the Financial Statements

The Statement of the Management Responsibility for preparation of the financial statements was not presented along with the financial statements of the Project.

2.2.2 Accounting deficiencies

The following accounting deficiencies were observed.

- (a) Machineries procured at a cost of Rs. 42.17 million for testing of environmental effects on use of refrigerators had been shown under work - in progress instead of being capitalized under the property, plant and equipment.
- (b) The balance remained in the Imprest Account maintained by Central Bank of Sri Lanka as at 31 December 2016 amounting to Rs.2.55 million had not been brought to the financial statements of the Project.

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 to be financed according to the Project Administration Manual		Allocation made in the Annual Budget Estimates for the year under review		Funds utilized during the year under review as at 31 December 2016		
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	1.93	216.16	75.00	0.12	17.82	0.38	56.48
GOSL	0.09	10.01	1.00	-	0.02	0.05	7.48
Total	<u>2.02</u>	<u>226.17</u>	<u>76.00</u>	<u>0.12</u>	<u>17.84</u>	<u>0.43</u>	<u>63.96</u>

According to the information presented, only US\$ 0.38 million equivalent to Rs. 56.48 million representing 19.68 per cent of the allocation of US\$ 1.93 million equivalent to Rs. 216.16 million had been utilized at the end of the period of the Project. The allocation of US\$ 1.29 million equivalent to Rs. 144.48 million made to grant sub loans to the Plantation Companies to encourage them to develop micro- hydro projects had remained underutilized, as adequate actions were not taken by the Project to popularize the credit line.

3.2 Physical Progress

According to the Project Administration Manual, the improvements on energy efficiency and development of renewable energy sources were the main expected outputs of Part - 07 and Part-08 of the Project. Therefore, activities such as consultation supports to carry out detailed technical studies and development of eligibility criteria for funding purposes of micro - hydro rehabilitation and grid connections for the estate sector were expected to be carried out by the Project. Further, the other activities of assessments on engineering, environmental and social monitoring issues, establishment of credit line of US\$ 1.29 million equivalent to Rs. 144.48 million to private developers for 19 micro - hydro projects providing 1.3 megawatt of grid - connected capacity on a net metering basis and procurement of lighting appliance testing laboratory equipment were also expected to be carried out.

According to the information received, a Licensed Specialized Bank had been selected by the Project, as the Financial Institution to disburse the Sub Loans under the credit line to develop 06 micro - hydro projects. However, only one micro – hydro project had been completed by a Plantation Company as at 31 December 2016. It was revealed in audit that the adequate attention had not been made by the Plantation Companies to implement the proposals for micro - hydro power generation activities, due to the failures in the global tea market and financial constrains faced by the plantation companies thereon.

3.3 Systems and Control

The transactions of the Project had not been subjected to audit of the Internal Audit Section of the Sustainable Energy Authority, as required by the Financial Regulation 134(3) and Management Audit Circular No. 05 of 26 July 2010.