

Supporting Electricity Supply Reliability Improvement Project – 2017

The audit of financial statements of the Supporting Electricity Supply Reliability Improvement Project for the first accounting year ended 31 December 2017 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 of Article IV of the Loan Agreement No. 3409-SRI dated 19 December 2016 entered into by the Ceylon Electricity Board with the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, the Ceylon Electricity Board and the Ministry of Power and Renewable Energy are the Executing and Implementing Agencies of the Project. The objective of the Project is to enhance the efficiency and reliability of the electricity supply and distribution systems. As per the Project Administration Manual, the estimated total cost of the Project amounted to US\$ 160.20 million equivalent to Rs.23,069 million and out of that the US\$ 115 million equivalent to Rs.16,560 million was agreed to be provided by the Asian Development Bank with the guarantee of Democratic Socialist Republic of Sri Lanka. The Project commenced its activities on 29 June 2017 and scheduled to be completed by 30 September 2021.

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 as necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 Auditors 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 misstatements of the financial statements, whether due to fraud or error. In making those risk assessment, 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 controls so as to ensure a satisfactory control over Project management and the reliability of books, records, etc. relating to the operation 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 operation of the Project, the identification of the purchases made out of the Loan, etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, material and equipment supplied under the Loan 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, and
- (h) Whether financial covenants laid down in the Loan Agreement 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, I am of opinion that,

- (a) the Programme had maintained proper accounting records for the year ended 31 December 2017 and the financial statements give a true and fair view of the state of affairs of the Program as at 31 December 2017 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the initial deposits, closing balances and withdrawals from and replenishments to the Imprest Account had been truly and fairly disclosed in the books and records maintained by the Program and the balance as at 31 December 2017 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 Agreement, and
- (e) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

According to the information received the civil construction works had neither been commenced and nor expenses incurred thereon during the year under review. The assets such as accessories for aerial bundle conductor, medium voltage insulators, tension set for Racoon 36 kilowatt, conductors and cables procured by the Project during the year under review at a cost of Rs.856.97 million and transferred to the Ceylon Electricity Board had been shown in the financial statements of the Project under the inventories. Further, a sum of Rs.112 million had been spent as the project monitoring expenses during the year under review and shown under civil construction work- in- progress.

2.2.2 Non – compliance with Law, Rules and Regulation

The Project Steering Committee had not been established as required by paragraph 09 of the Circular No.01/2016 of 24 March 2016 of the Department of Management Service.

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 as at 31 December 2017 are shown below.

Sources	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review		Fund utilized as at 31 December 2017	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	115.00	16,560.00	22.17	3,321	2.28	344.62
CEB	45.20	6,508.80	7.20	1,077	0.74	112.02
Total	<u>160.20</u>	<u>23,068.80</u>	<u>29.37</u>	<u>4,398</u>	<u>3.02</u>	<u>456.64</u>

The following observations are made.

- (a) Due to poor performance in execution of the activities of the Project , out of the total allocation amounting to Rs.4,399 million made by the Budget Estimate for the year 2017, only a sum of Rs. 456.64 million representing 10.30 per cent had been utilized during the year under review. Further, a sum of US \$ 24.30 million representing 14.8 per cent of the total allocation had been allocated in the Financial Plan of the Project for the year under review and out of that only a sum of US \$ 3.02 million representing 1.84 per cent had been utilized at the end of the year under review.
- (b) According to the Project Administration Manual, the Loan Agreement was required to be signed by 30 June 2016 and the activities of the Project were scheduled to commence by 30 September 2016. However, the Loan Agreement had been signed only on 19 December 2016 and became effective on 29 June 2017. As a result, the activities of the Project had been commenced with delays and utilization of funds had remained slow.

3.2 Physical Progress

The following observations are made.

- (a) According to the Loan Agreement, the activities of the Project were scheduled to be implemented under 04 main components such as establishment of hybrid renewable energy systems through different kind of power sources such as wind, solar, efficient diesel generators and batteries in the isolated islands of Nainathivu , Analathivu and Delfts in the Northern Province, improvement of reliability of the medium voltage network., extending rural electrification networks and improvement of distribution performance monitoring and improvements of the existing grid substation at Pannipitiya and Biyagama. However, a comprehensive Detailed Action Plan highlighting financial and physical targets with fixing responsibilities to ensure the achievement of objectives of the Project within scheduled time period had not been prepared and implemented.
- (b) Eventhough it was mentioned in the progress reports of the Project, the surveys on 33 kilowatts Lynx double circuit line of 270.50 kilometers had been completed, the survey reports thereon had not been submitted even as at 31 December 2017. As a result, , action had not been initiated even as at 31 July 2018 to select a contractor for construction works thereon. Further, land acquisition works for construction of gantries had not been completed as at 31 December 2017 and the approval from the Civil Aviation Authority, Department of Forest and Wild Life etc had not been obtained for lying of tower lines.
- (c) Out of 02 contract packages for rural electrification network, a contract package scheduled to be awarded during the year under review at an estimated cost of Rs. 591.84 million had not been awarded even as at 31 December 2017, due subsequent changes made in the specification. Further, the procurement contracts to be awarded at an estimated cost of Rs.1,729.44 million under 03 contract packages, according to the Annual Procurement Plan had not been awarded even as at 31 December

2017 due to various reasons such as delays in receiving the concurrence of the Lending Agency and instructions of the Procurement Committee.

- (d) Action had not been taken to award the contracts on construction of Hybrid renewable energy systems in Analathivu, Delfts and Nainathivu in the Northern Province even as at 31 December 2017, due to delays in clearance of lands and delays in receiving of the approvals of the Department of Coastal Conservation and respective Local Authorities.

3.3 Contract Administration

The following observations are made.

- (a) Eventhough the contracts had been awarded on 26 December 2016 to supply and delivery of materials such as reinforced concrete and pre-stressed poles, meter enclosure, galvanized steel wires, aerial bundle conductor and accessories at an estimated cost of Rs.1,865.36 million and paid an advance of Rs.104.53 million thereon. It was revealed in audit that the above mentioned materials had not been supplied even as at 31 December 2017. However, no reasons had been explained for the slow progress on supply of materials.
- (b) According to the report of the Lending Agency published in January 2016, the need of improvements on reliable supply of electricity to City of Kandy had been emphasis and allocation of US \$ 21.60 million under the component -04 of the Project had been made. However, the proposal had not been implemented and US \$ 20.43 million of above mentioned allocation had been transferred to improve the Grid Substations at Pannipitiya and Biyagama. The reasons thereon had not been explained to the audit. In addition, the construction contracts for Grid Substations had not been awarded even as at 30 June 2018.

3.4 Issues on Financial Controls

The following observations are made.

- (a) It was observed that Pay As You Earn Tax aggregating Rs. 3.76 million had been paid by the Project for the year under review on behalf of the staff members of the Ceylon Electricity Board, contrary to the provisions made in terms of Section 114 of the Inland Revenue Act, No.10 of 2016.
- (b) According to the Circular No DMA/D/2015 of 15 June 2016 of the Department of Management Audit, an Internal Auditor should be recruited for the Donor Funded Projects which exceeds the total estimated cost of US \$ 10 million. However, action had not been taken by the Project to recruit an Internal Auditor enable to establish proper monitoring mechanisms over the activities of the Project.