

Supporting Electricity Supply Reliability Improvement Project - 2019

The audit of financial statements of the Supporting Electricity Supply Reliability Improvement Project for the year ended 31 December 2019 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 between the Ceylon Electricity Board and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, Ceylon Electricity Board is the Executing and Implementing Agency of the Project. The objectives of the Project are to enhance the efficiency and reliability of the electricity supply and distribution systems. The activities of the Project are implemented under 4 components namely (a) establish hybrid renewable energy systems in small isolated islands (b) improve reliability of the medium voltage network (c) extended rural electrification network and (d) improve distribution performance monitoring and improve reactive power management in the transmission system. As per the Loan Agreement, the estimated total cost of the Project was US\$ 160.2 million equivalent to Rs 23069 million and out of that US\$ 115 million equivalent to Rs 16560 million was agreed to be financed by Asian Development Bank. The balance amount of US\$ 45.2 million equivalent to Rs 6508.8 million is expected to be financed by the Ceylon Electricity Board. The Project had commenced its activities on 29 June 2017 and scheduled to be completed by 30 September 2021.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 2.1 of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019, financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of this report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of management and those charged with governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Project ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Accounting Deficiencies

Nos	Audit Issues	Amount Rs million	Impacts	Management Responses	Auditor's Recommendations
(a)	The inventories procured under package 1-5 for the purpose of augmentation and maintenance activities of the Ceylon Electricity Board had been included in the value of inventories of the Project instead of shown as work-in-progress. Further, it could not be vouched and accepted in audit, due to they were unable to confirm the balances by carried out the physical verification either by Provincial stores or Project Monitoring Unit.	3,323.38	Overstatement of inventory balance	The balance of inventories amounting to Rs. 3,323.38 million (Rs3,374.48 million less 51.1 million) are supplied to Ceylon Electricity through package 1,2,3,5 of Supporting Electricity Supply Reliability Improvement Project. According to the Project Administration Manual of SESRIP, the purpose of Package 1,2,3 & 5 is to supply and provide goods to Ceylon Electricity Board for the augmentation and maintenance activities of CEB. Package 1,2&3 were carried out by Distribution division 02, the material was distributed to the provincial stores for CEB as agreed with Asian Development Bank at the time of the signing of the agreement.	Inventories relevant to the Project required to be reflected in the financial statements.
(b)	Inventories amounting to Rs. 3,374.48 million disclosed in the financial statements included value of inventories Rs. 51.1 million belongs to the contractor.	51.1	Overstatement of inventory balance	The inventories valued at 51.1 million are imported under the Package 4 of SESRIP. Action will be taken to transfer to the Work-in—progress of	-Do-

Therefore, value of the inventories had been overstated by Rs. 51.1 million in the financial statements.

package 4.

(c)	<p>Work-in-progress aggregating to Rs. 842.88 million related to other divisions shown in the financial statements for the year 2018 which were reported as unverified balances in the previous year's audit report had been omitted in the financial statements of the year 2019 without being given any valid reasons.</p>	842.88	<p>Omission of work in Progress.</p>	<p>Work in Progress in other Division denoted the material provided to the provincial stores and consumed for the construction activities of Ceylon Electricity Board. The material was provided for the construction activities of CEB and hence, the materials received were mentioned in the financial statements of the Project.</p>	<p>Instructions should be given and monitor to maintain separate registers at the Provincial Stores to identify the materials that are distributed by the Project as the Provincial Stores could not confirm any balances at present.</p>
(d)	<p>The detailed records on trade and other payables valued at Rs.84.62 million shown in the financial statements had not been maintained by the Project since the inception of the Project. Therefore, trade and other payables of Rs. 84.62 million shown in the financial statements could not be verified in audit.</p>	84.62	<p>Accuracy of the trade and other payables value is doubt.</p>	Not commented	<p>Action should be taken to maintain proper books and record to verify the balances.</p>
(e)	<p>According to a letter of confirmation of balances directly received from a private company, a sum of Rs. 17.39 million was required to be settled by the Project as at 31 December 2019, whereas there was a payable balance of Rs.16.54 million in favour of the said company shown in the financial statements as at that date.</p>	0.85	<p>Understatement of payables</p>	Not commented	<p>Action should be taken to reflect the actual payable balances in the financial statements.</p>

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| (f) | Although the expenditure made out of the contribution of the Ceylon Electricity Board, sufficient audit evidence such as payment schedules, vouchers and journal entries were not made available in audit. | 290.69 | Accuracy of the expenditure incurred is in doubt. | The details of Capital Employed by CEB is attached please. Annex 03 | Action should be taken to maintain proper books and record to verify the expenses. |
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2.2 Non-compliance with Laws, Rules and Regulations

No	Reference to the Rules and Regulations	Non-Compliances	Impacts	Management Responses	Auditor's Recommendations
(a)	Sri Lanka Accounting Standard LKAS -7	Project had not considered the Mobilization Advance and the Project Development Expenditure (WIP) relevant to the Package 7 during the preparation of the cash flow statements.	Could not assess the proper impact of activities of the financial position of the Project and the amount of its cash and cash equivalent.	No comments	Due concern needed on preparation of the financial statements
(b)	Sri Lanka Accounting Standard LKAS 16	Fully depreciated vehicles including a car WP GB-9464 purchased in 2002 and the double cab WP PE-5057 purchased in 2012 are being continuously used by the Project without revaluing the useful economic lifetime of those assets and accounting them accordingly.	Under statement of Property Plant and Equipment	No comments	Due concern needed on preparation of the financial statements
(c)	Financial Regulations 1646	vehicle running charts required to be submitted as per the regulation had not been submitted for audit.	A sum of Rs 1.3 million spent on vehicle fuel and oil could not be verified	No comments	Regulations need to be complied.

			in audit.		
(d)	Financial Regulations 761	Inventory books had not been rendered to audit.	A sum of Rs. 3,374.48 million recorded as inventories in Provincial stores could not be verified in audit.	No comments	Regulations need to be complied.
(e)	Public Enterprises Circular No PED 01/2018 dated 18 September 2018 issued by the Ministry of Finance and Mass Media	The circular requirement had not been adhered on the procurement made during December 2019 on seventeen motor vehicles which includes a Sport Utility Vehicle and sixteen four wheel driven double cabs at a cost of Rs. 23.4 million and Rs. 153.5 million respectively. The price ceiling including all taxes had not been decided by the Director General of Public Enterprises (DGPE) considering the market price of the vehicle during the procurement of vehicles for Projects (Vehicle requirements should have been clearly identified by the respective State Owned Enterprises in consultation with the DGPE at the initial implementation stage of the Project). Further the approval of procurement of vehicle had not been sought through the Chairmen and the Secretary to the line Ministry from the Department of Public Enterprises.	The necessity of vehicle procurement at the final stage of the Project and the unecological cost incurred on Sport Utility Vehicle which is irrelevant to fulfill the task of the Project	Tender was advertised on 15/02/2018. The vehicle requirement of the project was included in the scope of the tender after getting the approval from a committee established in the ministry of power and energy.	Approval of the General Treasury as per the para 03 of the Public Enterprises Circular No PED 01/2018 dated 18 September 2018 issued by the Ministry of Finance and Mass Media has to be complied with.

(f)	Public Enterprises Circular No PED 28 dated 31.01.2005.	Necessary approval had not been obtained on the vehicle hire and a sum of Rs. 27.04 million spent for hiring charges during the year under review.	Un economical expenditure	No comments	Circular instructions need to be complied.
(g)	Management Services Circular No 01/2019 dated 05 March 2019 issued by the Ministry of Finance – Paragraph 9	Action had not been taken to Establish a Steering Committee for Project which should be chaired by the Secretary of the line Ministry and consists of an officer nominated by the Secretary to the Treasury, an officer nominated by the Secretary to the Ministry to which the National Planning and External Resources Departments are assigned and the Director General , Department of Project Management and Monitoring or a representative nominated by him/her and to meet at least once in two months.	Lack of Management supervision and Monitoring on the Project activities	A Project Steering Committee is not appointed.	Circular instructions need to be complied.
(h)	Public Finance Circular No PFD/RED/03/03/01 dated 17 October 2014 and provisions stipulated in section 3.1.7 and 3.2.7 of the Para 03 of the Public Finance Circular No 05/2016	An annual board of survey had not been conducted and the respective reports had not been submitted to the Auditor General.	The existence and the condition of the asset could which belongs to the Project could not be verified in Audit	No comments	Circular instructions need to be complied.
(i)	Financial Regulations 507	Physical verification of stores and fixed Assets as at 31st December had not been carried out	The actual existence and condition of store items could not be satisfactorily verified in au-	CEB carries out a physical verification for all the stores of CEB annually and the verification	Physical verification of stores and fixed Assets as at 31st December has to be carried out in order to identify

			dit.	reports submitted without any failure.	are the Project inventories and assets.
(j)	Management audit Circular No. 02/2016 dated 10 June 2016 issued by the Secretary of the Ministry of Finance.	Action had not been taken to recruit an Internal Auditor for the Project.	Proper monitoring mechanisms over the activities of the Project and to ascertain the level of benefit to the public without delay and to verify the transparency of the financial management of the Project are curtailed.	Currently, the auditing of projects is within the preview of the Internal Audit Branch of CEB and is being allocated to an Internal Auditor who is currently responsible for carrying out the internal audit activities of all the projects belong to the Project Division of CEB.	Close supervision needed on the Project activities.

3. Physical Performance

3.1 Physical and Financial Progress of the activities of the Project

According to the Loan Agreement, the activities of the Project were scheduled to be implemented under 04 main components to establish hybrid renewable energy systems of wind, solar, efficient diesel generators and batteries in the islands of Nainathivu, Analathivu and Delfts in the Northern Province, to improve the reliability of the medium voltage network including to extend the rural electrification networks and improve the distribution performance monitoring and improve the capacity existing grid substation at Pannipitiya and Biyagama. However, the respective activities had been commenced with considerable period of delays over a year from the scheduled date of 31 July 2016 and continued operations without taking any actions to catch up the delays. The following observations are made.

No	Components	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
(a)	Three hybrid renewable energy mini-grids in isolated islands Analathive, Delft and Nayanativu	According to the Project Administration Manual, contract on construction of the Hybride renewable energy systems in Analathivu, Delfts and Nainathivu in the North-	Possibility of extension of the Project period which could increase the related costs.	Two lands in Analativu and Delft are government lands and they have been allocated for this project. Relevant DSs have granted approval	Action should be taken to expedite the land acquisition works and take necessary action to award the contract without further

ern province was required to be awarded by 3rd Quarter of 2017 and the activities of the contract were scheduled to commence by 4th Quarter 2017. However, the draft bid documents for this package was approved by ADB on 4th July 2017, the contract had not been awarded as at 31 December 2019. Even though the 3 lands had been surveyed to acquire under this package there were no land acquired even the date of audit on 03 June 2020.

for using the lands in delay. 2018.

The land in Nainativu is a private land and CEB has purchased it in 21/07/2020.

(b) Reliability improvement of the medium voltage network	According to the Project Administration Manual contract on construction of 270.5 km long 33 km tower lines and 13 No. of 33 kv gantries at an estimated value of US \$ 34.99 million was required to be awarded by 3rd Quarter of 2016 and the activities of the contract were scheduled to be commenced by 4th Quarter of 2017. However, the procurement process had been taken for more than two years to awards this contract Finally, the contract was awarded on 30 May 2019 at a cost of US \$ 40.48 million and the effective date of this contract was 06 July 2019. Even though 10 plots of land were	Possibility of extension of the Project period which could increase the related costs.	According to the <i>Resettlement Plan</i> published by ADB in April 2016 on SESRIP project, ADB recommended to give priority on purchasing the required lands other than acquiring. Therefore, all steps were done to identify suitable lands which can be purchased from the land owners. Details and owners of few such lands have been identified and presented on the ADB published Resettlement Plan. However, some lands identified at the planning stage of the project prior to set up the PMU had to be changed because of	Action should be taken to expedite the works and need to monitor the works of contractors closely
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scheduled to be acquired for construction of Gantries under this component, no land had been acquired even after lapse of 3 years. Further it was revealed that even though the survey works had been completed by CEB on all 16 no of line routes, approvals had been received only for 12- line routs by the respective Divisional Secretaries even the date of audit on 1 June 2020.

the various reasons.

(c) Rural electrification and distribution performance monitoring	Even though the contracts had been awarded on 26 December 2016 undue delays were observed in supply and delivery of poles and meter enclosure under the package 01 and 02 of two private companies. This was pointed out in the previous year's audit report and found no action had been taken by the Project officials even during the year under review. Hence an aggregated amount of Rs. 19.5 million to be claimed from the two companies as liquidity damages as per clause 27.1 of section VIII of special conditions of contract had not been claimed during the year under review.	Undue favouration made to the contractor.	-	Actions should be taken to deduct liquidated damages from the contractors
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- (d) Reactive power management in the transmission system. Even though a sum of Rs. 3,806 million had been allocated to install 100 MVar BSC at Pannipitiya Grid substation and Static Var Systems (SVS) at Biyagama Grid substation, the contract on installation of 100 MVar BSC at Pannipitiya Grid substation had been awarded on 9 May 2019 at an estimated cost of US\$ 1.5 million, Euro 3.76 million Rs. 166.05 million with a delay of 2 1/2 years since the commencement of the activities of the Project. The other contract had not been awarded even the date of audit on 1 June 2020.
- Possibility of extension of the Project period which could increase the related costs.
- Under SESRIP Lot 7 package A1 the work is in progress and package 7 A2 – (100MVar SVS at Biyagama GS) was awarded on 28-05-2020. This would have been awarded in the fourth quarter of 2019. But was not possible due appeals to the Procurement appeal Board and subsequent changes in the administration due to changes in Ministries after the presidential elections. The pre-award meeting was held amid the Covid 19 pandemic with the participation of foreign parties through zoom meetings and managed to award the contract on 28th May 2020.
- Action should be taken to expedite the works and need to monitor the works of contractors closely.

3.2 Underutilized Resource

Audit Issue	Impact	Response of the Managements	Auditor's Recommendation
According to the financial targets stipulated in the Project Administrative Manual, it was expected to be utilized US\$ 54 million equivalent to Rs 7,776 million at the end of the year under review and only 43.42 per cent of the respective targets had been achieved as at that date.	The commitment charges amounting to Rs. 22.81 million had been recovered by the Lending Agency. Entire allocations during the rest of 3 ½ years of the Project could not be utilized.	Actions have been taken to expedite the Project activities in order to meet the financial targets stipulated in the Project Administration Manual	Need to adopt with the financial targets stipulated in the Project Administrative Manual

3.3 System and Controls

No	Audit Issue	Impact	Response of the Management	Auditor's Recommendations
	Supervision and monitoring of the activities of the Project under the 03 major components were remained under the preview of 03 separate Divisional Heads of the CEB.	Delays in implementation and monitoring of the activities of the Project due to lack of proper coordination.	-Do-	Need to be strengthen controls on monitoring supervision