Sri Lanka Sustainable Energy Authority - 2011

1. Financial Statements

1.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 1.2 of this report, the financial statements give a true and fair view of the financial position of the Sri Lanka Sustainable Energy Authority as at 31 December 2011 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Sri Lanka Accounting Standards (SLAS)

The following observations are made.

(a) **SLAS 3 - Presentation and Disclosures in the Financial Statements**

Significant accounting assumptions and estimations and date of authorization for issuing the financial statements had not been disclosed.

(b) **SLAS 18 - Property, Plant and Equipment (PPE)**

Revaluation of PPE of the Authority had not been done and the zero valued PPE which are still being used had not been disclosed in the financial statements as per SLAS–18.The historical cost of zero valued PPE as at 31 December 2011 was Rs.16,388,545.

(c) **SLAS - 29 - Revenue**

Revenue includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. However, the Authority had recognized all its income other than the interest on Fixed Deposits and Treasury Bills on cash basis without recognizing on accrual basis.

(d) **SLAS 30- Related Party Disclosures**

Related parties and related party transactions had not been disclosed in the financial statements as required.

1.2.2 **Accounting Deficiencies**

Following observations are made.

(a) Deficiencies observed in accounting of the transactions of the newly constructed Solar Park at Hambantota were as follows.

(i) Only the equipment received to the value of US $ 1,663,316 out of agreed foreign aid grant of US $ 3 million as per the Terms of Reference included in the agreement entered into between the Authority and the Korean Federation on 09 December 2009 for the Solar Power Project had been taken into the accounts. The other facilities provided within the financial limit of US $ 3 million as per the agreement had not been ascertained and brought to the accounts.

(ii) The land acquired from the Mahaweli Authority to the extent of 50 acres for Solar Park had not been valued and brought to the accounts.

However, the Chairman of the Authority stated in this regard as follows.

"The Authority has initiated the acquisition process and waiting for the deed of the land from the Mahaweli Authority. The block of land under reference will be taken into the Assets Register on the conclusion of the acquisition process."

(b) As pointed out in my previous year audit report, a sum of Rs. 897,025,919 payable to the Ceylon Electricity Board for the purchasing of electricity during the period 2008 - 2009 from non-conventional renewable energy producers as per the Cabinet Decision dated 31 March 2008 had not been taken into accounts.

However, the Chairman of the Authority stated in this regard as follows.

"The Sri Lanka Sustainable Energy Authority currently has no means of making this payment, unless funds are granted by the General Treasury or from earnings through CESS, royalties etc. subject to the approval of the General Treasury."

(c) A sum of Rs. 608,661 being interest earned by the Energy Fund in 2010 by depositing its income of Rs. 28,861,798 in a Bank Saving Account had been inappropriately treated as an income of the Authority. This had not been rectified even in 2011.

(d) The total Government grant which had not been treated as deferred grant prevailed as at 01 October 2008 was Rs.15,023,944. The net book value of the Property Plant and Equipment procured from those grants remained as at that date was Rs.14,095,553. However, those assets had been fully depreciated at present and the amount equal to the book value of those assets had been adjusted to the accumulated fund balance in 2011 instead of being adjusted to the net surplus balance as at 01 January 2010 in the statement of changes in equity. As a result, the net deficit and accumulated fund balance shown in the financial statements as at 31 December 2011 had been understated by Rs.14,095,553.

(e) Interest earned from investment of the collection to the Sri Lanka Sustainable Energy Fund and Sri Lanka Sustainable Guarantee Fund amounting to Rs. 30,426,250 during the period 2008 – 2011 had been utilized for the expenditure of the Authority without reinvesting to enhance the respective Funds.

(f) Equipment cost relating to the incompleted wind towers had erroneously been accounted as Property, Plant and Equipment (PPE) and as a result, the work-in-progress (WIP) and the PPE shown in the financial statements had been understated and overstated by Rs.1,419,000 respectively.

(g) One out of five Wind Towers capitalized in 2010 had been fully damaged and action had not been taken to remove it from Fixed Assets Accounts. Therefore, the fixed asset shown in the financial statements had been overstated by Rs. 2,377,000.

(h) The amount accounted under work-in-progress (WIP) in 2011 was Rs. 15,523,945 but the amount taken into the Cash Flow Statement as WIP was Rs. 38,301,046. Hence, net cash used in investing activities shown in the Cash Flow Statement had been overstated by Rs. 22,777,101.

(i) Cash flow from interest income was Rs. 5,611,777 but the amount taken into the cash flow statement was Rs. 5,128,721. Hence, the net cash used in investing activities shown in the cash flow statement had been understated by Rs. 483,056.

(j) Cash flows from capital grant shown in the cash flow statement had been overstated by Rs. 5,019,888 due to erroneous computation.

(k) The value of completed works amounting to Rs. 53,824,991 transferred from work-in-progress account to property, plant and equipment in 2011 had erroneously been treated as purchase of PPE in the cash flow statement and as a result, the investing activities shown therein had been overstated by the same amount.

(l) Following observations are made in respect of the energy instruments of Rs. 24,169,380 received as foreign aid grant in 2009.

(i) The depreciation and differed revenue applicable to the energy instruments had not been accounted for. As a result, the differed grant and energy instruments shown in the financial statements as at 31 December 2011 had been overstated by Rs. 22,493,705.

(ii) The energy instruments received on 29 December 2009 amounting to Rs. 838,500 had been fully depreciated in 2011 and adjusted the entire amount in the previous year net surplus balance. Due to that erroneous accounting treatment, the net surplus as at 31 December 2010 and the deficit and the PPE balance shown in the financial statements as at 31 December 2011 had been understated by Rs.559,000 and Rs.279,500 respectively.

(m) Following transactions relating to the Regional Centre for Lighting (RCL) which should have been accounted separately had inappropriately been included in the financial statements of the Authority as at 31 December 2011.

Item	**Amount**
	Rs.
Capital Expenditure	10,416,735
Recurrent Expenditure	20,493,912
Total	**30,910,647**

(n) Generally, estimation errors should be adjusted to the current year and no need to treat as prior year adjustments in the income statements. However, under provision of the gratuity for the year under review amounting to Rs. 773,757 had erroneously been treated as prior year adjustment and shown separately in the income statement.

(o) The deficit and the net surplus shown in the income statements for the year under review and the previous year respectively had not been tallied with the equity statement and differences of Rs.773,757 and Rs.3,739,868 had been observed between those two figures respectively as details given below.

Description	**2011**	**2010**
	Rs.	**Rs.**
Surplus/ (deficit)		
As per Income Statement	(31,405,292)	7,023,548
Surplus / (deficit)		
As per Equity Statement	(30,631,535)	3,283,679
	---------------	--------------
Difference	**773,757**	**3,739,868**
	=========	=========

1.2.3 **Unexplained Differences**

The Authority was not in position to explain the net difference of Rs. 2,792,181 in amortized differed grant shown between the Note – 14 and Note – 10 to the financial statements to audit. Details are given below.

Description	**Amount**
	Rs.
Amortized Differed Grant	
as per Note – 14 to the financial statements	106,395,700
as per Note – 10 to the financial statements	89,507,966

Difference	16,887,734
Less: Depreciation adjusted erroneously **(Refer paragraph 2.2.2(d) in this report)**	14,095,553

Net difference	**2,792,181**
	========

1.2.4 **Lack of Evidence for Audit**

Computation details of the deferred revenue transferred to the income statement of the year under review amounting to Rs. 106,395,700 was not made available for audit.

1.2.5 **Non-compliance with Laws, Rules and Regulations.**

Following instances of non-compliance were observed in audit.

(a) **Finance Act. No 38 of 1971**

(i) **Section 8(1)** – The annual budget of the Authority for the year under review had been approved by the Board of Directors only on 28 January 2011 i.e. three months later.

(ii) **Section 14(1) -** A draft annual report which should have been furnished along with the draft financial statements was furnished to the Auditor General only on 02 August 2012 i.e. six months later.

(b) **Sri Lanka Sustainable Energy Authority Act No 35 of 2007**

(i) Sub section 46(2) – Action had not been taken to collect the funds from activities such as initial capital from the consolidated Fund, funds from CESS (Section 45) etc. other than the application fee.

The Chairman of the Authority stated in this regard as follows.

"From the inception of the Authority, at each budget preparation, proposals were made to evoke the provisions of the subsection. However, the officials involved in the preparations objected to these measures as likely to contribute to further increased cost of fossil fuels."

(ii) Sections 46.3(a), (b), (c), (d) and (e) – The funds amounting to Rs.96,856,634 was idling in a Bank Saving Account as at 31 December 2011 without utilizing it for the following purposes as permitted by the Act.

- Subsidies for selected renewable energy based energy conversion plan.
- Subsidies for promoting the use of energy efficient appliances and technologies
- Capital subsidy for fuel switching, including industrial thermal applications
- Conducting awareness programmes
- Incentives or other similar financial assistance to any society or community for encouraging the utilization of renewable energy sources

The Chairman of the Authority stated in this regard as follows.
"***From the inception of the Authority, at each budget preparation, proposals were made to evoke the provisions of the subsection.***
However, these efforts failed to bare any fruit. From the inception of the Authority a set of proposals in line with the objects of the Authority were presented for inclusion in the budget proposals to the Department of Fiscal Policy and Department of National Planning."

2. Financial and Operating Review.

2.1 Financial Review - Financial Results

According to the financial statements presented, the operations of the Authority for the year under review had resulted in a deficit of Rs.31,405,292 as against the net surplus of Rs. 7,023,548 for the preceding year, thus indicating a decrease of Rs.38,428,840 in the financial results. Main reasons attributed for the decrease in financial results were the reduction of the recurrent grant by the Government due to over estimation of the budgeted income for the year under review, and increase of normal and project related recurrent expenditure incurred from of the recurrent and capital grant as against the previous year. Details are given below.

Item	**2011** Rs.	**2010** Rs.
Other income	31,278,917	29,059,774
Total recurrent expenditure other than project expenses	(76,589,930)	(65,107,881)
Expenditure over income before adjusting the recurrent grant for administration expenditure and capital grant for Project expenditure	**(45,311,013)**	**(36,048,107)**
Net surplus/(deficit) arisen between capital grant and expenditure transferred from capital projects	(17,320,522)	(3,668,345)
Expenditure over income before adjusting the recurrent grant for administration	(62,631,535)	(39,716,452)
Recurrent grant for administration expenditure	32,000,000	46,740,000
Net Surplus / (Deficit)	**(30,631,535)**	**7,023,548**
	=========	========

According to the above analysis, the deficits for the year under review and the previous year before adjusting the government contribution were Rs. 45,311,013 and Rs. 36,048,107 respectively. However, after adjusting the Government contribution, it was converted into deficit and surplus of Rs. 30,631,535 and Rs. 7,023,548 for the year under review and previous year respectively. Hence, it was evidenced that the Authority had fully depended on the Treasury funds.

The Chairman of the Authority stated in this regard as follows.

"***The SLSEA is engaged in promoting and educating on sustainable energy in the country. And also acts as the regulator of new projects in Renewable Energy. Most of the revenue it generates through energy permits etc. is deposited in the Energy***

Fund and is set aside for special activities described in the Act. Only the income generated from the solar power plant in Hambanthota could be utilized for the capital projects of SLSEA in specified areas. This income is limited to about Rs.40 million annually but the capital project budget is well over this amount. On the other hand restructuring and expanding of SLSEA was required to recruit new staff and office space and other facilities resulted to increase amount of recurrent expenses. The General Treasury has so far not allowed the SLSEA to implement their fund generation activities, such as CESS, Royalty etc as sanctioned by the Act. Hence, the Authority could not become a self-financing institution yet."

2.2 Operating Review

2.2.1 Regional Centre for Lighting

The Regional Centre for Lighting (RCL) had been established within the Authority in April 2009 in view of the widespread benefits expected through the introduction of the efficient lighting system. In this regard following observations are made.

(a) Decision to function the Centre as a separate unit under the Ministry of Power and Energy or a separate unit under the Authority had not been finalized yet. However, according to the information made available, it was observed that the Centre had been functioned as a separate unit under the Authority in 2011.

The Chairman of the Authority stated in this regard as follows.

"***Since energy saving as a result of efficiency improvement in lighting would be directly benefitted the CEB, on the request of the Ministry the CEB undertook the operation and management of the centre in later part of the year 2012.***"

(b) Achieving the targeted income of Rs. 12.3 million in 2011 from testing of Compact Florescent Lamps (CFL) in the Lab established in the Authority had not succeeded due to non designing of a mechanism for that. Further, the Centre had not been efficiently and effectively used for the intended purposes during last two years period even the Authority had spent a sum of Rs. 30,249,692 as at 31 December 2011.

The Chairman of the Authority stated in this regard as follows.

"Although the objectives of the Centre could not be fully achieved during its first two years of operation, the photometry laboratory has been established and funding for procurement of equipment was secured. Further, training facilities and other infrastructure has been established."

2.2.2 **Development of Three Prototype Electric Vehicles**

The Authority had entered into an agreement with a private company to develop three prototype electric vehicles for Rs. 9 million on 28 September 2007. Accordingly, the project required to be completed within 18 months from the date of the agreement.

According to the agreement, due date for completion of the Project was 31 May 2009. However, the developer had failed to develop even a single vehicle out of three prototype vehicles although Rs.7.824 million i.e.86.93 per cent of the agreed sum had been paid and taken 56 months as at 31 May 2012. It was further observed that the developer had dragged on the project without formal time extension because he has not impacted from that delay.

2.2.3 **Supply, Fabrication, Installation and Commission of Ten Wind Measuring Masts**

The Authority had entered into an agreement with a private Company on 14 July 2008 for a sum of Rs. 16,675,000 for supplying, installation and erection of ten wind measuring masts at places selected in four Provinces. According to the Contract, the Project period was 12 months and after issuing of the completion certificates the defect liability and maintenance period was also 12 months. In addition to the contract value, the Authority had spent a sum of Rs. 7,095,000 for instruments and other accessories. In this regard following observations are made.

(a) Only four out of ten Masts had been completed within the project period and the balance towers except Karabagala had been completed after two years period late from the due date.

The Chairman of the Authority stated in this regard as follows.

"A project of this nature requires careful positioning of the measuring towers to gain a good knowledge of the wind resource. Accordingly, selection of appropriate measuring sites took a considerable time. Measures will be taken to conclude the project within the current financial year."

(b) Progress of the construction of Kabaragala Wind Tower was only site selection stage as at 23 April 2012. However, the instruments and other accessories valued at Rs. 634,500 relating to that Tower remained with the contractor.

The Chairman of the Authority stated in this regard as follows.

"The material required for the Kabaragala measuring site (last site) has been mobilized. The Contractor is planning to conclude the installation within two months period."

(c) According to Clause No. 16 of the agreement, the Contractor was required to warrant the components free of corrosion or any other defect for a minimum period of two years. However, it was observed in audit that the Authority had ignored the said provision and taken the responsibility to replace the inferior material, used by the contractor, at its own cost of Rs. 461,440.

The Chairman of the Authority stated in this regard as follows.

"The offer made by the Contractor included an alternative offer to have stainless steel stay wire for corrosive environments. The Authority decided to reject this expensive, alternative offer an opted to investigate the suitability of mile steel stay wire.

Accordingly, the Contractor was not held responsible for the corrosion of the stay wires."

(d) According to the clause Nos.18 and 19 of the agreement, the Contractor was liable to insure against the all risk contemplated by the Authority and contractor will further be held responsible for all insurable risks of every kind other than war, rebellion and earth quakes that occur during the period of maintenance. However, ignoring these provisions, the Authority had decided to release contractor from all liabilities arisen as a result of collapse the wind measuring Mast at Udappuwa on 07 October 2010 as it was happened due to the natural disaster.

However, the Authority had not taken action to investigate the incident to establish the contractors fault. Further, it was observed that the location of the collapsed tower had been selected after measuring wind and doing feasibility studies by incurring public funds. However, the information furnished to audit revealed that the Authority has no intention to re-erect a new Tower at that location. Hence, the amount spent for the tower had become fruitless.

(e) According to Clause No 16 of the agreement, the Authority should retain 10 per cent of the contracted sum as retention money for a period of 12 months of operation. However, the Authority had paid to the Contractor a sum of Rs. 15,007,500 (i.e. 1,675,000 × 90% × 10) as at 25 March 2009 even only four Towers had been completed at that time and one Tower was still at the initial stage as at 23 April 2012 as mentioned in paragraph (b) above. Therefore, stage wise payment instead of measure and pay could not be accepted in audit for the Project like this because the Authority had lost the control over project administration.

2.2.4 Development of Local Wind Turbine Studies to Complex Terrain in Sri Lanka

The objectives of the Project are to design and development a Wind Energy Conversion System suited to different terrain condition in Sri Lanka with a view to maximize local value addition and thereby encouraging local wind turbine manufacturing efforts in anticipation of creating employment and producing electricity at a competitive price. In this regard following observations are made.

(a) The Authority had entered into an agreement with a Private Company for diversification of Energy Resource Base/Development of a Wind Energy Conversion System with a view to maximize local value addition in harnessing wind energy on different terrain conditions in Sri Lanka on 01 March 2010 without complying of the provisions in Section 8(2)(b) of the Finance Act No. 38 of 1971. The Developer had estimated the total project cost at Rs.40.80 million out of which Rs.20.80 million to be borne by the Authority.

(b) According to Clause 7 of the Agreement, the total duration for the Development was eighteen months of which 12 months for prototype manufacturing and six months for field testing. But the Developer had not completed the Project even after taking 22 months without formal time extension as at 31 December 2011. The total amount paid to the Developer as at 31 December 2011 was Rs. 11.440 million and it was 55 per cent of the contracted sum of Rs. 20.80 million.

(c) The prudence and fairness of the total Project cost estimated to get 50 per cent from the Authority could not be satisfied in audit because the reasons and basis of valuation of certain items (eg. Land value and extent) included therein is questionable.

2.2.5 **Other Projects**

Renewable Energy Division of the Authority had planned to implement 24 programmes during the year under review at a total estimated cost of Rs. 197.3 million. However, ten programmes of them had not achieved any financial and physical progress as at 31 December 2011 and the total estimated cost in the annual budget for those programmes was Rs. 29.04 million. Considerable physical and financial progress of the balance programmes was also not observed.

The Chairman of the Authority stated in this regard as follows.

"Every year this Authority plans for activity-filed calendar based on existing staff assigning with multiple tasks. Accordingly, only the priority program has to be implemented sacrificing some of the planned activities and therefore hindered due to unavailability of funds from the Treasury on time. As a result, considerable deviation between the budgeted and the actual performance is experienced."

2.3 **Items of Contentious Nature**

A sum of Rs. 7,334,354 had been received to the Authority during the years 2010 and 2011 as the reimbursement of the expenditure incurred to carry out the Greening Sri Lanka Hotel Programme coming under the Project financially supported by Switch-Asia Programme, a European Union funded Project managed by the Ceylon Chamber of Commerce. Out of this, a sum of Rs.3,135,202 had been distributed among the entire employees of the Authority as professional allowance in contrary to the provisions in Public Enterprises Circular No. 95 of 04 June 1994 and Public Finance Circular No.PF/PE/5 of 11 January 2000.

2.4 **Human Resources Management (HRM)**

The Authority had functioned without having a staff recruitment procedure approved by the Department of Management Services (DMS) in 2011 as well.

Further, the approved and actual cadre as at 31 December 2011 was 114 and 85 respectively. Twenty two out of twenty nine vacancies i.e. 76 per cent was in managerial level and above.

The Chairman of the Authority stated in this regard as follows.

"We have conducted detailed review of the staff recruitment and a new organization structure was designed. The new structure has been referred to the Sri Lanka Institute of Development Administration (SLIDA) by the Ministry for review."

2.5 Corporate Plan

Previous Corporate Plan was for the period 2006 -2010 and the new plan is for 2012 – 2016. However, the Authority had functioned without a Corporate Plan in 2011.

2.6 Budgetary Control

Significant variances were observed between the budgeted and the actual income and expenditure for the year under review thus indicating that the budget had not been made use of as an effective instrument of financial management control.

3. Systems and Controls

Deficiencies observed in systems and controls during the course of audit were brought to the notice of the Chairman of the Authority by my detailed report issued in terms of Section 13(7)(a) of the Finance Act. Special attention is needed in respect of the following areas of control.

(a) Budget
(b) Assets Management
(c) Debtors and Creditors
(d) Accounting
(e) Implementation of Projects
(f) Human Resources Management (HRM)
(g) Staff Loans
(h) Payment Procedure