

CLEAN ENERGY AND ACCESS IMPROVEMENT PROJECT - 2013

The audit of the financial statements of the Clean Energy and Access Improvement Project for the year ended 31 December 2013 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 2.09 (a) of Article II of the Loan Agreements No. 2518 and No. 2519 SRI (SF) and Grant Agreement No 0149 - SRI dated 17 June 2009 entered into between the Asian Development Bank (ADB) and the Ceylon Electricity Board (CEB) and Lanka Electricity Company (Private) Limited (LECO).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan and Grant Agreement of the Project, the Executing Agency of the Project is the Ministry of Power and Energy and the Implementing Agency for all Parts of the Project shall be the CEB and LECO shall implement Parts 3 and 4 jointly with CEB. The objectives of the Project is to realize affordable and reliable power supply by improving the coverage and service efficiency of the CEB and LECO through (i) a stronger transmission and distribution network, and demand – side management of municipal street lightning; (ii) removal of network bottlenecks for small hydropower plant; and (iii) stronger transmission network in the Eastern Province and an expanded credit support programme for service connections in selected provinces.

As per the Project Administration Memorandum of June 2009, the total estimated cost (TEC) of the Project is US \$ 188.2 million equivalent to Rs 20,284.8 million and out of that US \$ 164.2 million equivalent to Rs.17,689.2 million was agreed to be financed by the Asian Development Bank. The Project commenced its activities on 09 February 2010 and was scheduled to be completed by 31 May 2013. However; the period had been extended from 30 November 2013 to 30 November 2015 in relation to the Loan No 2518 and from 30 November 2013 to 30 September 2015 in relation to the Loan No 2519. Subsequently the ADB had extended the closing date of the Grant to 30 September 2014. A summary of the source of finance is given below.

<u>Source</u>	<u>Part No</u>	<u>US \$ (Million)</u>	<u>US \$ (Million)</u>	<u>SLRS (Million)</u>	<u>SLRS (Million)</u>
Asian Development Bank Ordinary Capital Resources (OCR) Loan - CEB	1,2,5,6 & 7	114.4		12,324.3	
LECO	3	20.6	135.0	2,219.2	14,543.5
Asian Development Fund (ADF) Loan – CEB	7	21.5		2,316.1	
	8	3.5	25.0	377.0	2,693.1

Grant –					
Government of Japan *	4	2.0		215.6	
Climate Change Fund	4	2.2	4.2	237.0	452.6

Subtotal			164.2		17,689.2
Government of Sri Lanka (GOSL)			24.0		2,585.6
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TEC			188.2		20,274.8
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*Provided through the Asian Clean Energy Fund under the Clean Energy Financing Partnership Facility, and administered by the ADB.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

2. **Scope of Audit and Basis of Opinion**

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessments of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore, believe that my audit provides a reasonable basis for my

opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records 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 Project management and the reliability of books, records etc., relating to the operations of the Project;
- (b) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the GOSL and the lending agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identification of purchases made out of the Loan/ Grant etc.;
- (c) Whether withdrawals under the Loans/ Grant had been made in accordance with the specifications laid down in the Loan and Grant Agreements;
- (d) Whether the funds, materials and equipment supplied under the Loans/ Grant had been utilized for the purposes of the Project;
- (e) Whether the expenditure had been correctly identified according to the classifications adopted for the implementation of the Project;
- (f) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards;
- (g) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and;
- (h) Whether financial covenants laid down in the Loans and Grant Agreements had been complied with.

3. Opinion

So far 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 5 of this report, I am of opinion that,

- (a) the project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purpose for which they were provided,
- (c) 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 and Grant Agreements,

(d) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(e) the financial covenants laid down in the Loan and Grant Agreements had been complied with.

4. Financial Statements

According to the financial statements and information made available to audit, the Project expenditure for the year under review amounted to Rs. 4,811,874,425 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 14,098,112,042. A summary of the expenditure for the year under review, expenditure for the preceding year and the cumulative expenditure as at 31 December 2013 is given below.

Activities	Expenditure for the Year		Cumulative expenditure as at 31 December 2013
	2013 Rs.	2012 Rs.	Rs.
System Control Modernizations	880,758,061	715,542,953	1,672,788,808
Transmission System Strengthening - Transmission Line	317,651,981	1,325,112,133	2,518,460,483
Transmission System Strengthening -Grid Substation	1,428,748,609	1,214,526,043	2,791,036,801
Net Work Capacity Augmentation for Renewable Energy	570,794,312	2,205,259,942	3,143,516,437
Consulting Services for System Control Modernization	4,745,085	15,521,436	34,754,050
Transmission System Strengthening in the Eastern Province	522,482,319	1,609,026,203	2,510,352,208
Distribution Substations Augmentations - LECO	1,075,169,083	121,604,939	1,407,975,204
Demand Side Management for Municipal Street Lighting - LECO	-	4,220,665	6,039,333
Demand Side Management for Municipal Street Lighting - CEB	<u>11,863,289</u>	<u>4,780,176</u>	<u>17,761,689</u>
Total Expenditure	4,812,212,739	7,215,594,490	14,102,685,013

Less other Income and Gains	(338,314)	(1,049,079)	(4,572,971)
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Total Net Expenditure	4,811,874,425	7,214,545,411	14,098,112,042
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5. Audit Observations

5.1 Rendition of Financial Statements

According to the Loan Agreement, the audited financial statements of the Project should be furnished to the Asian Development Bank as soon as available but in any event not later than nine months after the related fiscal year. It is the responsibility of the Project to furnish the financial statements to the Auditor General within a reasonable period enabling the Project to meet the above mentioned time target. However, the financial statements of the Project for the year ended 31 December 2013 were furnished to the Auditor General on 08 August 2014.

5.2 Accounting Deficiencies

The following observations are made.

- (a) Reimbursable foreign aid receivable as at 31 December 2013 amounting to Rs.15,467,796 under Parts 1 and 5 of the Project had not been brought to the accounts.
- (b) Seven vehicles out 57 vehicles purchased by the Project had been transferred to the CEB in 2013 but, their transferring cost had not been ascertained and adjusted in the financial statements of the Project.
- (c) According to the financial statements, the borrowing cost for the year under the review was shown as Rs.821,526,530. However, according to the calculations made by the audit, the borrowing cost should be Rs.871,489,088..
- (d) The contribution received from the CEB shown in the financial statements as at 31 December 2013 had been overstated by Rs.121,527,672 due to erroneous adjustments made for borrowing cost. Furniture the cash flows from financing activities shown in the statement of cash flow had also been overstated by a similar amount due to the above misstatements.

6. Financial and Physical Performance

6.1 Utilization of Funds

Certain significant statistics relating to the financing of the Project, budgetary provision and utilization of funds for the year under review and the cumulative utilization as at 31 December 2013 are shown below.

Source -----	Amount agreed to be as per the Financing Agreement -----		Budgetary Provision for the 2013 year -----	Funds utilized during the year 2013 -----	Cumulative Expenditure as at 31 December -----	Balance -----	
	US \$ million	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million	%
ADB Loan	164.2	17,689.2	4,784.6	3,604.4	10,727.2	6,962.0	39
GOSL / CEB	24.0	2,585.6	299.0	200.2	1,283.0	1,302.6	50
Total	188.2	20,274.8	5,083.6	3,804.6	12,010.2	8,264.6	41

Even though 69 per cent of the Project period was over by 31 December 2013, the financial performance of the foreign had been shown as 61 per cent which creates a material mismatch between the usage of foreign funds and the duration of the Project. The overall financial progress of the Project as at 31 December 2013 was 59 per cent only.

6.2 Physical Performance

It was observed that several improvement works had not been commenced or shown slow progress as at 31 December 2013 due to various reasons as described below.

- (i) The works related to construction of National System Control and Installation of Supervisory Control and Data Acquisition and Communication System under Lot I of package – A had not been commenced due to delays in concurrence of the Asian Development Bank.
- (ii) The scope of works related to Augmentation of Existing Grid Substation of Kurunegala had been changed subsequently and therefore, the work had been commenced only on 19 November 2013.
- (iii) The Augmentation work of existing Grid Substations at Horana and Veyangods had shown a shown progress due to delay in procurement of materials.
- (iv) Rural household connections had not been provided due to delays to select a financial service provider.

6.3 Project Monitoring

The activities of this Project does not come under the purview of the Additional General Manager (Projects) who is responsible for all foreign funded Projects handled by the Ceylon Electricity Board. As such, close monitoring of the entire activities under 08 parts were not done by the Ceylon Electricity Board.

6.4 Matters in Contentious Nature

Further, even though no provision are made available in the Project documents to purchase vehicles to provide transport facilities to the Engineers of the Project, four contractors had purchased 57 vehicles for that purpose, out of the Loan proceed. Further, those vehicles had been registered under the names of the contractor.

7. **Systems and Controls**

Special attention is needed in respect of the following areas of control.

- (a) Accounting
- (b) Reimbursements
- (c) Performance review