

Sustainable Power Sector Support Project – 2016

The audit of financial statements of the Sustainable Power Sector Support Project 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 Sections 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 the Sri Lanka Sustainable Energy Authority is the Implementing Agency for Part 7 and 8 of the Project. My observations on the activities carried out by Ceylon Electricity Board under the Part 01 to Part 06 and Part 09 and 10 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.18,135.45 million and out of that US\$ 118.07 million equivalent to Rs. 13,223.84 million or 72.9 per cent was agreed to be financed by the Asian Development Bank and the balance US\$ 42.03 million equivalents to Rs.4,707.36 million or 26 per cent was agreed to be provided by the Government of Sri Lanka. The Project commenced its activities on 17 November 2011 and scheduled to be completed by 30 April 2014. The scope of the Project had expanded for the use of savings of the proceeds of the Loan. Subsequently, the period of the Loan had been extended up to 30 October 2016. However, the activities of the Project were continued up to 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 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 withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreements.
- (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 funds, materials and equipment supplied under the Loans had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (i) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in previous year audit report, and
- (j) Whether the financial covenants liad 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 Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Project Loan Agreements,
- (d) the 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 Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) The value of the completed civil works amounting to Rs.2,198.91 million and the cost of the motor vehicles amounting to Rs.489.39 million transferred to the Ceylon Electricity Board had been accounted as the assets of the Project whilst depreciation amounting Rs.233 million respectively had been shown as expenditure of the Project.
- (b) The work-in-progress valued at Rs.368.51 million related to Reactive Power Management of the Project had been presented under the New Galle Power Transmission Development Project, due to a classification error.
- (c) An advance amounting to Rs.2.45 million made to an outside party on supply of 03 motor vehicles through the contractor engaged in civil construction works of the Project had been shown as the expenditure of the Project, eventhough the supply

contract had been subsequently cancelled and refunded the advances directly to the Lending Agency.

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 for financing in the Loan Agreements | | Allocation made in the Budget Estimate for the year under review | Funds utilized | | | |
|--------------|--|-------------------------|--|---------------------|------------------------|---------------------|-------------------------|
| | US\$ million | Rs. million | | US\$ million | Rs. million | US\$ million | Rs. million |
| ADB | 118.11 | 13,223.84 | 1,817.00 | 14.43 | 2,157.00 | 81.30 | 12,156.50 |
| GOSL | 43.92 | 4,911.61 | - | - | - | - | - |
| CEB | - | - | 138.00 | 0.25 | 37.00 | 12.95 | 1,936.00 |
| Total | <u>162.03</u> | <u>18,135.45</u> | <u>1,955.00</u> | <u>14.68</u> | <u>2,194.00</u> | <u>94.25</u> | <u>14,092.50</u> |

According to the above information, only US\$ 81.30 million equivalent to Rs.12,156.50 million representing 69 per cent of the total allocation of US\$ 118.11 million equivalent to Rs.13,223.84 million had only been utilized at the end of the period of the Project.

Physical Performance

According to the information made available, the works under the developments of New Galle Power Transmission, North East Power Transmission, Rural Electrification and Distribution System in the Uva Province, Reactive Power Management and Preparation of a Detailed Engineering Design approximately 30 Mw Run-of - river Hydropower Station of Moragalla Hydropower Station had been completed as at 31 December 2015. The balance of Rs. 1,118.50 million of the proceeds of Loan remained unspent were expected to be utilized for Augmentation of Kiribathkumbura Grid Substation Project, Supply and delivery of materials for expansion of Rural Electrification and Distribution System Improvement Project in Uva Province and Ampara and procurement of material for reconstruction of 02 transmission lines. According to the information received, the progress of works under the Augmentation of Kiribathkumbura Grid Substation had remained at 67 per cent and behind the targets on procurement of material for Rural Electrification and Distribution System Improvement Project in the Uva Province and Ampara and procurement of material for reconstruction of 02 transmission lines under Transmission Construction Project Branch causing financial difficulties to the Ceylon Electricity Board.

3.2 Issues on Financial Controls

The following observations are made.

- (a) As a practice, the Engineers' Estimate on civil works carried out by the Project are over estimated and the contracts on civil works are awarded to the contractor at lower costs. That fact had been accepted by the Secretary to the Ministry of Power and Renewable Energy by his Letter No: PE/TEN/SCAPC/SG/2015/41 of 18 July 2016 and a sum of Rs.1,118.50 million had remained unspent as at that date, due to overestimation of cost of the contracts.
- (b) According to information received, the commitment charges amounting to Rs.12.35 million had been recovered by the Lending Agency as at 31 December 2016, due to delay in implementation of the activities of the Project.
- (c) Material procured by the Ceylon Electricity Board for transmission construction purposes at a cost of Rs.497.99 million, out of the costs saved by the Project due to works un attended and over estimations made thereon had been shown under work-in-progress. However, such assets had remained unused at the end of the year under review.
- (d) The development expenditure aggregating Rs.1,087.53 million incurred during the year under review under the rural electrification and distribution system improvement works had been overstated by Rs.563.24 million, due to presentation error.