

Mahaweli Water Security Investment Programme - Tranche 1- 2023

The audit of financial statements of the Mahaweli Water Security Investment Programme - Tranche 1 for the year ended 31 December 2023 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 4.06 (a) of the Loan Agreement No. 3267-SRI and Section 4.03(a) of the Loan Agreement No. 3268 –SRI (SF) dated 17 September 2015 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. My comments and observations which I consider should be reported to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Programme

According to the Loan Agreement of the Programme, the Ministry of Irrigation is the Executing Agency and Sri Lanka Mahaweli Authority and Department of Irrigation are the Implementing Agency of the Programme.

The objective of the Programme is secure access to water resources for agricultural, drinking and commercial purpose in programme area. The activities of the Programme are implemented under three components namely North Central Province Canal Project, North Western Province Canal Project, Minipe Left Bank Canal Rehabilitation Project.

As per the Loan Agreement, the estimated total cost of the Programme was US\$ 190 million equivalent to Rs. 26,720.80 million and out of that US\$ 150 million equivalent to Rs. 21,095.37 million was agreed to be financed by Asian Development Bank. The balance amount of Rs. 5,625.43 million is expected to be financed by the Government of Sri Lanka.

The Programme had commenced its activities on 24 June 2015 and scheduled to be completed by 31 December 2019. However, the date of completion of the activities of the Programme had been extended up to 30 June 2025.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Programme as at 31 December 2023, statement of expenditure and its cash flows for the year then ended in accordance with Sri Lanka Public Sector 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 my 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 Public Sector 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.

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

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 scepticism 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 Programme.
- 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. Physical Performance

2.1 Physical progress of the activities of the Programme

Components	As at 31 December 2023		Delay/ Audit Issue	Responses of Management	Auditor's Recommendation
	Expected physical performance	Performance achieved			
	Units/ percentage	Units/ percentage			
Construction of the Mahakitula Inlet tunnel	100	2.97	The company, which undertook the construction of this contract for the period of 2020- 2024 at a value of Rs.9,978.48 million, was unable to maintain the construction progress as planned due to the lack of suitable staff and construction equipment for construction work and poor work site management. As a result, the contract was terminated on 26 May 2023.	Agreed.	A new contractor should be appointed and the rest of the construction should be completed, soon.
The construction of 2 Mahakitula and Mahakirula Reservoirs and the construction of the 3.66 km Feeder Canal between the 2 reservoirs under North Western Province Canal Project.	100	1.5	(i)For the construction of the Mahakitula and Mahakirula reservoirs and the improvement of the Mahadambe reservoir in between, 47,552 trees in a forest area of 778 acres had been cut down by the Timber Corporation. At the time of cancellation of the contract, 1.5 percent of the work on the dam had been completed by cutting the foundations and laying clay for the	Agreed.	A new contractor appointed and the rest of the construction start and Investigate the payment of consultancy fees over the value of the work done in the contract.

preparation of the embankment of the Mahakitula Reservoir at a cost of Rs. 58.2 million. For the construction supervision of work worth Rs. 58.2 million, Rs. 139 million had been spent on staff salaries, office expenses and vehicle maintenance to the consulting company.

(ii) There were no plans to complete the remaining parts of the contract and only the Mahakitula entrance tunnel and the associated canal were to be completed within the period of 2024-2027 under the Ministry of Irrigation with the use of local funds of Rs. 2,742 million. A provision of Rs.1,000 million had been allocated for that from annual estimate of the year 2024.

Due to the unavailability of ADB financing or any other alternate financing re-awarding of the balance work is not possible at present.

Should plan get funds to complete the project .

2.2 Delay in Completion of activities of the Project

Audit Issue	Date scheduled to be completed	Date Completion	Delay year	Responses of Management	Auditor's Recommendation
(a) The contract of construction the 17+050 km canal from Nabadagahawatta to Mahakitula Reservoir inlet tunnel of the North	2018– 2021	Time extended to 05 December 2023	02½	Land acquisition had been completed and construction proceeded	Land acquisitions and compensation payments had finished within the stipulated time.

Western Canal. The contract had been delayed for such a long period without being able to construct 355 meters of the canal, because having forwarded 03 land owners to Compensation Review Board due to compensation received was not sufficient for 06 plots of land.

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| (b) | Due to this delay, the contract, which was awarded for Rs 7,226.62 million (inclusive of VAT), had increased to Rs 15,154.74 million by Rs. 7,928.12 million which was 110 per cent. The approved price variance of Rs.162 million had increased to Rs.5,827.7 million by reasoning the increase in the cost of construction materials due to the economic and financial recession from the year 2022. | 2018 – 2021 | – Time extended to 05 December 2023 | 02½ | Agreed. The price fluctuation had to be paid as per the contract conditions which use FIDIC formula for price adjustment and CIDA price indices. | Actions should be taken to complete the contract within stipulated time. |
| (c) | Although the contract period had been extended only up to 05 December 2023, the contract was not completed even by 31 December 2023 and the construction progress was 91.4 per cent on that day. | 2018 – 2021 | Time extended to 05 December 2023 | 02½ | Agreed. The contractor suffered from bad weather condition from September 2024 to December 2024 and became entitled for an extension of time up to 17th May 2024. | Steps should be taken to complete the contract soon. |

2.3 Contract Administration

No.	Audit Issue	Responses of Management	Auditor's Recommendation
(a)	<p>Technical Assistant of the project appointed by the Asian Development Bank later joined the service of the consulting company of the Programme and has been working as the Team Leader & Chief Design Engineer for a period of 07 years. He was being paid a monthly salary of 26,000 Euros (Rs. 8.5 million) for that, and by June 2023 he was paid Rs. 702.18 million as salaries. By deploying a person who assisted in the programme preparation tasks on behalf of the Asian Development Bank, in the consultancy firm of the programme, the independence of programme supervision had been challenged. It was also contrary to get the services of this consultant in terms of Paragraph 1.11 of the "Guidelines on the Use of Consultants by Asian Development Bank and its Borrowers" issued by the Asian Development Bank in 2013.</p>	<p>Procurement process of the consultant had been carried out by the Ministry and ADB. Therefore, the Procurement should be in line with ADB guidelines.</p> <p>The payments for the consultancy team are paid in line with the Consultancy Agreement.</p>	<p>Programme Supervision should be independent and recruitments should be in line with ADB guidelines.</p>
(b)	<p>Although the consultancy fees are to be paid based on the performance of the contracts since it can be determined on the scope, output and the length of the services in the proposed construction contracts, a consultancy contract agreement worth US\$22.09 million for a period of 60 months from 16 November 2015 had been entered with the consultant of the programme for payment on the time basis. Due to the project duration had been extended since the delay in the construction work of the Project, the contract agreement of consultancy had been extended on 06 occasions up to 30 June 2024 and the cost had increased to US\$ 41.56 million by having to pay consultancy fees on the basis of this extended time period. As only US\$ 25.93 million had been allocated to pay consultancy fees for Tranche 1 and 2 by the Asian Development Bank, the exceeded consultancy fees had to be paid from the allocations for other expenses.</p>	<p>This consultancy agreement contains,</p> <ul style="list-style-type: none">• Task dependent lump-sum payments• Time dependent time based payments <p>depending on the nature of services required from the consultant.</p> <p>The time based services are obviously sensitive to the "time for completion" of construction contracts hence had to be extend until construction contracts are completed.</p> <p>Original allocation for Consultancy Services was USD 22.09 million for Tranche 1 and 60 months' period only. Several Amendments and variations were approved for Tranche 2 tasks, scope change items and some variations during implementation period.</p>	<p>Steps should be taken Consultancy fees paid based on the agreement and Disciplinary actions taken against the officials of the project who responsible for paying the consultancy fees by using the money that allocated for other constructions by submitting the Cabinet papers.</p>

- (c) At the beginning of the Project, 34 foreigners were recruited for consultancy works and at present 8 foreigners were working. A foreigner was being paid a salary ranging from 16,000 to 26,000 Euros (from Rs. 5.5 million to Rs. 9 million) per month and subsistence allowances ranging from 70 to 110 Euros per day. Salaries of 12,843,998 Euros (Rs.4, 341 million) and subsistence allowances of 1,068,599 Euros (Rs.361.18 million) had been paid to these foreigners by 30 June 2023.
- The payments for the Consultancy Services are paid in line with the Consultancy Agreement.
- (i) Steps should be taken not to pay subsistence allowances to people who have been working at a certain place for a long time and are getting monthly salary.
- (ii) Should be made arrangements to complete the project soon and reduce the expenses for consultancy.
- (d) The foreign consultancy company had recruited 161 local employees through its 02 affiliated local companies and 110 of them were working by now. In addition to these staff, consultancy fees were being paid on a time basis for a staff of 48 working in the Colombo project office and 08 working in worksite offices located in the contract areas.
- Not Agreed.
- As at June 2023,
- Colombo office - 34 staff members
 - Work sites – 117 staff members were paid on time basis.
- (i) Since the relevant authorities are responsible for not to prepare a system that minimizes the cost of consultation from the beginning, suitable actions should be taken against them.
- (ii) Should be made arrangements to complete the project soon and reduce the expenses for consultancy.
- (e) In accordance with paragraphs 1.11 (b) and (c) of the “Guidelines on the Use of Consultants by Asian Development Bank and its Borrowers” issued by Asian Development Bank in 2013, the company or companies selected for the consultancy contract shall not undertake other contracts (e.g.- preparation of design plans, environmental assessments) in relation to the relevant project. Those companies should not be re-appointed for consultancy if they have been done earlier and people who have family and business relations with the employees of the
- These two assignments have been carried out in two different periods of the timeline, therefore could be considered as mutually exclusive.
- The selection of consultant had been done by the Ministry with the ADB.
- Due to contrary to the ADB guidelines, these informal methods which selecting consultants, should be stopped immediately and followed The guidelines issued by the Asian Development Bank..

Asian Development Bank and borrower (Ministry of Irrigation) should also not contribute to the consultancy. However, Infotech IDEAS Company had received an amount of Rs.102.98 million through the Mahaweli Consultancy Bureau Company for preparing the design plans, environmental assessment reports, feasibility study reports and modification reports for the construction of North Central and North Western Canals and Minipe Canal Rehabilitation projects in this program since 2015. Further, it has been working as the Sri Lanka representative company of Tractable, which was the main consultant of this program, the main staff of this company consisted of retired officers from the borrower's Ministry of Irrigation and its subordinate institutions.

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| (f) | For the construction of temporary buildings using Amano sheets for the use of contractor's, the consultant company's and the consultant company's canteen, Rs.41.59 million, Rs.18.32 million and Rs.7.4 million were paid respectively, and after the cancellation of the contract, the buildings were handed over to the project. However, all the air conditioners installed in the buildings used by the contractor had been removed and handed over. | As per the provision of the contract in case of a demobilization all such temporary facilities along with the fittings and fixtures are to be removed as part of the restoration by the contractor. | The temporary buildings taken over should be assessed by an independent party and if any overpayment, should be recovered from the contractor. |
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2.4 Extraneous Activities/ Payment made out of the Project objectives

Audit Issue	Responses of Management	Auditor's Recommendation
An amount of Rs. 10 million had been allocated under this contract, for the repair and modernization of the Devahuwa Engineering office belonging to the Irrigation Department and without fulfilling that, a two-storied house had been obtained on rental basis for the consultant company of the project by spending Rs.9.6 million.	However, at the initial stage of the contract, the Devahuwa Irrigation Department building was inspected for renovation and since it was not in repairable condition, the option chosen in a very short time was to rent the most centrally located building for the project and establish the Resident Engineer's office.	Actions should be taken to perform the planned activities.

2.5 Matters in Contentious Nature

No.	Audit Issue	Responses of Management	Auditor's Recommendation
(a)	<p>Including Water Control and Measurement Facilities for Left Bank and Right Bank Canal of the the contract of Heightening of Minipe Anicut had been awarded to a foreign company at a value of Rs. 1,864.80 million (without tax) on 05 January 2018 and it should have been completed on 12 November 2020. Nevertheless, due to various reasons the contract period had been extended up to 31 July 2021 by 243 days. Although installing a sludge removing gate in the center of the proposed Minipe anicut had been planned and after recognizing that may cause practical problems in subsequent operation and maintenance of the gate had been removed. Being given 134 days to remove those activities had become a controversial matter.</p>	<p>This was a result of the subsequent improvement made to the tender design for functional and operational ease. Relocation of proposed middle silt ejector was done after thorough study carried by the technical review committee comprising key stakeholders. This resulted an extension to the contractors' time program.</p>	<p>Planning activities should be made after considering all relevant factors.</p>
(b)	<p>The above contract had been carried out for almost 02 years without having an extension and, the construction progress of the contract was 22 per cent during this period. It had been decided in the Meeting of Cabinet of Ministers held on 05 June 2023, to increase the value of this contract up to Rs.2, 912.85 million, to sign the amended agreement No. 02 to have the rest of the work done by the same contractor, and to extend the contract period up to 21 September 2023. Accordingly, although the contract agreement had been signed, the contract value had not been included in the revised agreement. There was a high value for price variation such as Rs. 996.10 million in the increased contract value of Rs. 1,048.05 million.</p>	<p>The amendment to the contract agreement was made to revise only few sub clauses of conditions of contract. All other Conditions of the original Contract agreement still prevail as per the main agreement. The Accepted Contract Amount given in the original agreement means the amount accepted in the letter of acceptance for the execution and completion of the works and remedying of any defects (Sub clause 1.1.4.1). However, the Contract Price means the price defined in sub clause 14.1 and includes adjustments in accordance with the contract which not necessarily required to be documented at each revision.</p>	<p>(i) Actions should be taken against the project officials who responsible for not having planned properly at the beginning of the contract. (ii) Contract agreements should be prepared carefully and make sure all necessary information have included prior to sign. (iii) Actions should be taken to complete the construction soon.</p>

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| (c) | The contract to construct a canal length of 6.225 Km from Moragahakanda Reservoir under the North Central Province Grand Canal Project had been offered to a local contractor during the period of 2016 to 2020 at a cost of Rs. 3,254.29 million. The progress of the construction even as at 31 May 2021 was only 64 percent, and the work could not be completed due to the financial constraints of the contractor. The contract had been cancelled on 13 July 2021, due to inability to continue. However, as a case had been filed preventing the recovery of losses from the advances and performance guarantees kept in the bank by the contractor, the mobilization advance amounting to Rs.185.89 million and the performance security valued at Rs. 390.51 million to be charged from the contractor could not be recovered. | The contract was not “cancelled” but “terminated”
The related court case had been referred to Attorney General Department and waiting for an outcome | Expedited construction of the remaining construction and unfinished parts of the contract should be finished through another contractor. |
| (d) | The loan agreements between the Government of Sri Lanka and the Asian Development Bank have not yet been signed for the Tranch-03, and the 03 main contracts of the North Western Canal Project to be completed in the period 2019-2023 have not been started so far. | Agreed
Due to the unavailability of ADB financing or any other alternate financing re-awarding of the balance work is not possible at present. | To get approved from appropriate Line Ministry and Treasury to carry out the rest of the construction of the North Western Canal Project. |

2.6 Identified Losses

Audit Issue	Responses of Management	Auditor’s Recommendation
The Programme had incurred a commitment charges due to underutilize of allocate fund for the period from 2016 – 2023 amounting of Rs. 117.14 million as at 31 December 2023.	The project performance was slow due to various reasons such as, delay in land acquisitions, water issues, bad weather, Easter attack, covid-19 situation and consequential economic crisis. So The loan was not utilized planned, a higher commitment charges had been incurred.	Strong financial control and activities should be performed accordance with the plan.