

Mahaweli Water Security Investment Programme - Tranche 2 - 2023

The audit of financial statements of the Mahaweli Water Security Investment Programme - Tranche 2 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 4.02 (a) of the Loan Agreement No. 3625-SRI and Section 4.02(a) of the Loan Agreement No. 3626 –SRI (COL) dated 18 May 2018 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 two components namely North Central Province Canal Construction and North Western Province Canal Constructions.

As per the Loan Agreement, the estimated total cost of the Programme was US\$ 242 million equivalent to Rs. 38,177.67 million and out of that US\$ 210 million equivalent to Rs. 33,129.39 million was agreed to be financed by Asian Development Bank. The balance amount of Rs. 5,048.28 million is expected to be financed by the Government of Sri Lanka.

The Programme had commenced its activities on 13 December 2017 and scheduled to be completed by 31 December 2021. 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 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	By constructing the North Central Provincial Canal, the Mahakanadarawa Reservoir will receive water and meanwhile the Anuradhapura North Water Supply Project was started and its work was nearing completion, with a loan obtained from the Japan International Cooperation Agency and funds from the Government of Sri Lanka under the estimated allocation of Rs. 11,515 million to supply drinking water to Rambewa and Medavachchiya areas by using water of Mahakandarawa reservoir. Nevertheless, due to the failure of the North Central Provincial Canal Project to be implemented within the stipulated time, that drinking water project remained at a level that could not be implemented until the water of this project reaches the Mahakanadarava Reservoir.	Agreed.	Identify the priority work and Steps should be taken to complete the project stipulated time period.
(b)	The program is about to end of the year 2025 and by then, it is currently planned to complete only the 27.7 km long tunnel of the North Central Provincial Canal, which runs 96 km from Moragahakanda Reservoir to Kanadara Oya. Due to this, a definite plan for constructing the remaining 68.3 km canal and reaping the benefits of the entire project was not presented till the date of audit.	All the documents for procurements of balance contract packages are ready. At any time, these can be tendered and awarded once the fund allocations will be available. Department of External Resources are carrying out discussions with various international funding agencies in order to arrange the finances.	Action should be taken to definite plan for remaining works and construction works should be complete within the stipulated period.
(c)	A sub-project of providing and installing 50 units of Poly Tunnel for locally produce hybrid chilli seeds to farmers in 5 Mahaweli Zones and Hurulu Wewa area, under the Agriculture Productivity Enhancement Project, was executed at a contract value of Rs.91.57 million. The contractor selected for this was a government company with poor financial feasibility, having made losses during 2018-2020 and turning a profit only in 2021 and had no prior experience in the construction of Poly Tunnel. According to the agreement, the work should be completed by 15 May 2023, but only 42 Poly Tunnels had been installed by 30 April 2024 and the period had been extended on three occasions till 31 May 2024.	Any delays beyond the latest time for completion (31 May 2024) will be treated as per the contract.	To get Proper plan and supervise relevant work to be complete by the extended date.

- | | | | |
|-----|--|--|--|
| (d) | Under the program, the work on the contract for the construction of the tunnel connecting Kaluganga - Moragahakanda, which was awarded at the value of Rs. 7,146.91 million in the year 2018, was to be completed on 10 September 2021, Although due to the inability to complete it within the stipulated time, it was extended to 21 December 2023. However, as of that date, construction progress was 90 percent and although the contract was estimated to be completed by 31 May 2024, no extensions were granted beyond 21 December 2023. | Another extension up to 31st August 2024 has been recommended by Standing Cabinet Appointed Procurement Committee and Cabinet of Minister's approval is pending. | Actions should be taken to investigate the reasons for the delay of the contract and have to give a reasonable time period for complete. |
| (e) | The commitment charge amounting to Rs. 229.23 million had incurred by the project due to underutilizing the allocated fund for the period from 2018 to 2023 as at 31 December 2023. | The project performance was slow due to various reason. | Investigate the reasons for negligence and activities should be performed according to the plan. |

2.2 Matters in Contentious Nature.

No.	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	During the construction of the above canal, the Department of Wildlife Conservation had informed that the construction of the canal within the Minneriya-Giritale Natural Reserve, Sigiriya Sanctuary, Minneriya National Park and Hurulu Wewa Reserve should be done using Cut & Cover, Double Conduit or Tunnel methods only. However, the project had not been complied with that and chosen the method of digging tunnels using 02 tunnel boring machines and moving water through those which was a high-cost method, showing it as the technically appropriate, nationally effective, and environmentally least impact method.	Not Agreed. During the planning, Designing & Implementation stages of NCPCP Canal, every possible action has been taken to accommodate the condition in EIA full filling the technically appropriate, nationally effective and environmentally least impact methods. Accordingly most of the areas were covered with cut & cover double conduit and tunnel.	The proper technical and effective methods should be implemented.
(b)	The consulting company had estimated the cost of manufacturing, importing, transporting and installing a tunneling machine at Rs. 7,255.40 million. The contractor had been submitted a quotation of Rs. 6,690.97 million for that and according to the invoice submitted to the project during the import of 02 machines, the CIF values of the 02 machines were US\$10,581,673 equivalent to Rs. 2,147.97	Estimated value and the CIF value can't be compared. The value of engineer estimate covers anticipated CIF value of the product, all the taxes associated with importation of machinery and equipment, handling charges, transportation from port to the site, installation assembling, launching and commissioning + mark – up.	Estimates should be prepared and reviewed after considering all relevant sources and factors.

million and US\$9,476,342 equivalent to Rs. 3,523.61 million respectively. Accordingly, the consultant company had prepared over estimation for this item without obtaining confirmation of the value of a machine while preparing the bill of quantities.

- | | | |
|--|---|--|
| <p>(c) Although the total cost of Rs. 6,690.97 million was paid to the contractor for import from China and transport to the work site of the 1st tunnel boring machine, by the location of the tunnel boring machine was released at the port of Trincomalee, its cost was Rs. 2,155.97 million. Accordingly, for transportation and assembly of the machine from Trincomalee to (d) Namalpura and for the contractor's profit, Rs.4,535 million, which is 68 per cent of the total cost of the machine, was controversy at the audit.</p> | <ul style="list-style-type: none"> • Competitive bidding procurement procedure had been adopter in this contract. • The contact was awarded to the substantially responsive lowest evaluated bidder through cabinet approval. • The rate quoted for lump sum items (3.4.1.1) is the competitive price quoted by the bidder. • The payments have been made as per the provision of the contract. | <p>Actions should be taken to investigate the cost and recover overpayments if any.</p> |
| <p>(d) Agreeing to pay a total amount of Rs. 6,690.97 million to the contractor for importing the 02nd tunnel boring machine from China and transporting it to the work site, Rs. 6,021.87 million had been paid by 15 March 2024. By the time the tunnel boring machine was released from the Trincomalee Port, its cost had been Rs. 3,635.61 million. Accordingly, the fact that Rs.3,055.36 million or 46 percent of the cost was paid for the transportation from Trincomalee to Konduruwa and assembly the machine and the contractor's profit was controversy at the audit.</p> | <p>Refer the response given above.</p> | <p>Actions should be taken to investigate the cost and recover overpayments if any.</p> |
| <p>(e) Due to the delay of 2½ years in the award of the contract, the completion date of the contract was 10 March 2027. Under the acceleration of the project, it was decided to deploy a 2nd tunnel boring machine for the construction of the distance of 10.4 km which was to be constructed under the Drill & Blasting method to complete the contract in June 2025. At there, the Technical Evaluation Committee appointed</p> | <ul style="list-style-type: none"> • The revised contract period with 2 TBM Machines. (8th June 2025) • The procurement process was temporally held up for 2 ½ years to further review the experience in water ingress Uma Oya Project which is similar to this project in nature. <p>By considering pros- cons of deploying a Second TBM, with the</p> | <p>When this purchase was not recommended by two Technical Evaluation Committees, the parties that appointed a special Technical Evaluation Committee, obtained recommendations, and arranged to import this</p> |

by the Director General of the State Finance Department had not recommended deployment of 2nd tunnel boring machine. Then the Ministry Secretary had appointed a Special Technical Evaluation Committee and that committee had also recommended that the feasibility of the proposal was doubtful and that the investment of additional funds for the contract could not be justified. The decision of that committee was also not accepted and a reconstituted Special Technical Evaluation Committee had recommended deployment of a 2nd tunnel boring machine. In this regard, at the Cabinet Paper submitted on 14 October 2021, had not been informed the Cabinet.

recommendation of the engineer to the project and with the concurrence of the ADB, cabinet of Ministers has granted necessary approval. High attention is given on the necessity to complete the construction works within the availability period of ADB Financing (MFF).

tunnel boring machine at a higher price are responsible for this. Therefore, actions should be taken against that party. All matters related to the purchase should be communicated to the Cabinet.

(f) According to the work estimate, Rs. 179.99 million had been provided in the bill of quantities for removing the 2 tunnel boring machines and transporting them to the port at the end of the contract. In that case, it was not agreed by the agreement to recover a reasonable amount from the cost paid for 2 machines worth Rs.13,381.94 million, and it was agreed to carry the 2 machines out of the country free of charge.

- All these actions are in line with the employers requirement of the bidding document for which the bidders have submitted their bid.
- The amount paid for machines are agreed lump sum rates of the contract.

At the end of the contract, when re-exporting the 02 machines, should be valued and charged a reasonable amount from the contractor and for that, the relevant clauses of the contract agreement should be revised.

(g) The Geological Survey and Mines Bureau had not given permission to excavate using a tunnel boring machine in the 3rd tunnel of the canal by now. Nevertheless, 5.77 km of the tunnel had been excavated using the 1st tunnel boring machine using the currently valid mining permit.

Even in the EIA, it is not mentioned that the necessity of obtaining license from GSMB. Even during the meeting in the Project although the officers from GSMB were present none of them raised the necessity of such license. Project Director had inquired in writing from GSMB about the necessity but no reply has received so far.

Mining license should be obtained from GSMB.

(h) It was estimated Rs. 2,892.3 million for fixing of concrete rings (Ring) in weak rock areas of the tunnel, and Rs. 928.72 million and Rs. 149.82 million for the construction of a ring manufacturing factory and a warehouse respectively. However out of 2,967 concrete rings installed in the tunnel as at 31 January

Though the values stated herein do not exactly tally with the relevant BOQ items or the site records on identified cracks, the said occurrence is accepted as occurred. The Specialists of Engineer and Contractor have been engaged with identification of causes and methods

Action should be taken to rectify this issue.

2024, 1,298 rings or 44 percent were identified as having cracked.

of rectification as per the internationally accepted standards. Employer too has maintained high attention on the on-going treatment processes.

- (i) The progress of the 27.7 km tunnel excavation contract was 21 percent as at 31 December 2023. Although Rs 3,001.79 million had been set aside to pay for price escalation in the contract, Rs 5,131.24 million had been spent by 31 December 2023. Accordingly, Rs 2,129.45 million had been paid excessively without obtaining the approval of the Ministers of Cabinet.

General practice is to revise the contract price once the total expenditure would note to be exceeded the accepted contract price previously approved by the cabinet of the ministers. Still this in this particular contract this situation has not arisen.

Cabinet approval should be obtained for additional payments.

2.3 Idle Resources

Audit Issue

Due to the fact that the Cabinet of Ministers has decided not to operate the imported 2nd tunnel boring machine temporarily from March 2023 to March 2024, after the installation of the machine, it was idle for a period of 8 months from March 2023 and the operation was started from 23 November 2023. From that date to 29 February 2024, progress of digging the tunnel was at a minimum level of 400 meters for a period of 3 months.

Response of the Management

Noted.

Auditor's Recommendation

Actions should be taken to complete the project work within stipulated time period.

2.4 Matters pointed out in Previous Audit Report which remained unresolved

Audit Issue

When a stock of fertilizer purchased under the program in 2022 was handed over to 02 fertilizer companies under the Ministry of Agriculture, there was a shortage of 161.5 metric tons (3,230 bags) of fertilizer valued at Rs. 55.23 million.

Response of the Management

Action has been initiated to investigate this issue. This information will be disclosed as a "Note" in the Financial Statements by 2024

Auditor's Recommendation

Expeditious actions should be taken to charge the loss from respective responsible parties and the loss should be disclosed in the financial statements.

2.5 Issues relating to the Land Acquisitions

644 lots of private land had to be acquired by the project, however only 385 lots of land had been acquired and none of the ownership of them had been transferred.