

Supporting Electricity Supply Reliability Improvement Project - 2020

The audit of financial statements of the Supporting Electricity Supply Reliability Improvement Project for the year ended 31 December 2020 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 4.05 of Article IV of the Loan Agreement No. 3409 -SRI dated 19 December 2016 entered into between the Ceylon Electricity Board and the Asian Development Bank (ADB). 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 Project

According to the Loan Agreement of the Project, the Ceylon Electricity Board is the Executing and Implementing Agency of the Project. The objective of the Project is to enhance the efficiency and reliability of the electricity supply and distribution systems. As per the Loan Agreement, the estimated total cost of the Project was US\$ 160.20 million equivalent to Rs.23,068.80 million and out of that US\$ 115 million equivalents to Rs.16,560 million was agreed to be financed by the Asian Development Bank. The balance amount of US\$ 45.2 million equivalent to Rs. 6,508.8 million is expected to be financed by the Government of Sri Lanka. The Project had commenced its activities on 29 June 2017 and scheduled to be completed by 30 September 2021.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 02 of my report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2020, financial performance and its cash flows for the year then ended in accordance with Sri Lanka 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 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 Project'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 Project.
- 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. Comments on Financial Statements

2.1 Accounting Deficiencies

| No | Audit Issues | Amount Rs. million | Responses of the Management | Auditor's Recommendations |
|-----|--|-----------------------|---|---|
| (a) | Payment made for purchase of land for the Plant proposed in Nainathivu had not been brought to the financial position of the Project during the year under review. | 2.86 | The preliminary expenses of Rs. 2,860,000 incurred on the purchasing of land have been recorded in the work in progress account, until the acquisition of the land is completed. | Correct accounting treatment should be applied. |
| (b) | Payment incurred for valuation and survey of Lands had not been recorded under the non-current asset after being identified the procurement of relevant Land for the Project. Instead this amount had been considered as a Capital expenditure and shown under the work-in-progress. | 0.76 | The total cost incurred for the construction of package 4 will be capitalized with the completion of package 4. | Correct accounting treatment should be applied. |
| (c) | An amount had been recorded as Capital Expenditure under the statement of work-in-progress. Type/nature of expenditure could not be verified as there were no supporting documents rendered to audit. | 163.23 | All the supporting documents were rendered to the National audit office with the submission of the financial statements of the project for the year 2020 on 13.05.2021. | Evidence should be available to audit ensure the existence of the assets and liabilities. |
| (d) | Furniture, fitting and equipment shown as it were incurred from the Project funds had not been brought to the statement of financial position of the Project during the year under review. | 0.17 | As per the policy of Ceylon Electricity Board, any expenditure incurred on Furniture, Fittings and Equipment for less than Rs. 30,000 is considered as a cost, thus, not capitalized. | The policy should be disclosed in the financial statements. |
| (e) | Sufficient and appropriate audit evidence had not been rendered to audit on capital employed by Ceylon Electricity Board. | 305.60 | The schedule for capital employed by CEB was submitted to the audit on 28.07.2021. | The Project should provide sufficient appropriate evidence for the auditors. |

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|-----|--|-------|---|---|
| (f) | Exchange gain and loss had been shown under the interest bearing loan instead of being shown separately under the non – current liabilities in the financial statements. | 14.71 | Separately disclosed under "E-8300 Exchange Gain/Loss Account" of Financial Statements 31/12/2020 Separately disclosed. | Disclosure should be made to provide correct information for the users. |
|-----|--|-------|---|---|

2.2 Unsettled Balances

| Ledger Account | Amount Rs. million | Period unsettled | Management Response | Auditor's Recommendation |
|--|--------------------|-------------------|---|---|
| The amount payable to two private companies as at 31 December 2020 remained without being settled for more than 2 years. | 25.22 | More than 2 years | The delay was occurred, due to the time taken for amicable negotiation. | Action should be taken to recover the liquidated damages. |

2.3 Non- Compliance with Laws, Rules and Regulations

| No | Reference to the Laws Rules and Regulations | Non- Compliances | Management Responses | Auditor's Recommendations |
|-----|---|---|---|---|
| (a) | Public Enterprises Circular No PED 01/2018 dated 18 September 2018 issued by the Ministry of Finance and Mass Media | Two sports utility vehicles and sixteen four-wheel drive cabs were procured at a cost of Rs. 46.8 million and Rs. 153.5 million respectively for the projects without clearly identifying the requirement of the Project. | CEB did not have vehicles to allocate project activities some vehicles were supplied under the project scope after getting the approval from a committee established in the ministry of power and energy. | Need to comply with Circular instructions. |
| (b) | Paragraph 9 of the Management Services Circular No. 01/2019 dated 05 March 2019 | The Project Steering Committee had not been established | Not replied | Action should be taken to establish Project Steering Committee. |

| | | | | |
|-----|--|--|--|---|
| (c) | Public Finance Circular No PFD/RED/03/03/01 dated 17 October 2014 and provisions stipulated in section 3.1.7 and 3.2.7 of the Para 03 of the Public Finance Circular No 05/2016. | An annual board of survey had not been carried out and the respective reports had not been submitted to the Auditor General. | Not replied | Need to comply with the circular instructions. |
| (d) | Management Audit Circular No. 02/2016 dated 10 June 2016 issued by the Secretary of the Ministry of Finance | Action had not been taken to recruit an Internal Auditor for the Project. | Internal Audit branch of CEB carries out overall audits. Internal auditor for each project is not appointed in CEB. | The transactions of the Project should be audited by the internal audit section of the CEB. |
| (e) | ADB requirement | Action had not been taken by the Project even on the date of audit to recruit a full time Treasury Management Professional within 03 months of signing the loan. | The Treasury Management Division of CEB has been established. Treasury Management Professional for each project is not appointed in CEB. | Need to comply with the ADB requirements. |
| (f) | Clause 27.1 of Section VIII of special conditions of contract | Action had not been taken by the Project to claim the liquidity damages | Distribution Division 02 has taken actions to consider the said two balances as late delivery charges and recorded in the financial year of 2021. The delay was occurred due to the time taken for amicable negotiation. | Need to comply with the conditions of the contract |

3. Physical Performance

3.1 Physical and Financial Progress of the Activities of the Project

According to the Loan Agreement, the activities of the Project were scheduled to be implemented under 04 main components to establish hybrid renewable energy systems consisting of wind, solar, efficient diesel generators and battery storage and support for productive energy use for small isolated Island and rural communities on Analathivu, Delfts and Nainathivu three Islands in Jaffna area of Northern Province, to improve the reliability of the medium voltage network including to extend the rural electrification network and improve the distribution performance monitoring and to improve the reactive power management in

the transmission system at Pannipitiya and Biyagama. However, the respective activities had been commenced with a considerable delay of more than a year from the scheduled date of 31 July 2016 and continued operations without being taking any actions to catch up the delay.

3.2 Delays in commencements/ implementation/ completion of activities of the Project

| No | Activity | Date scheduled to be commenced/ implement/ completed | Date of commencement/ implementation/ completion | Delay | Management Response | Auditor's Recommendation |
|-----|--|--|---|---|--|---|
| (a) | Establish Hybrid renewable energy systems in three small Islands - Analathivu, Delfts and Nainathivu | According to the Project Administration Manual, contract on construction of the Hybride renewable energy systems in Analathivu, Delfts and Nainathivu in the Northern province was required to be awarded by 3rd Quarter of 2016 and the activities of the contract were scheduled to commenced by 4 Quarter 2017. | Contract had not been awarded even as at 31 December 2020. Only the Land at Nainathivu had been purchased as at 31 December 2020. | More than 4 ½ years since the scheduled date of awarding and also more than 3 ¼ years since the scheduled date of commencement of activities as per the Project Administration Manual. | The TEC report is submitted to the SCAPC and the decision is pending from the committee. Hence, the awarding of the contract is delayed. | Action should be taken to award the contract without further delay. |
| (b) | Improve the Reliability of the Medium Voltage Network | According to the Project Administration Manual, contract on construction of 270.5 km long 33 kv tower lines and 13 No. of 33 kv - gantries at an estimated value of US\$ 34.99 million was required to | Contract was awarded on 30 May 2019 at a cost of US\$ 40.48 million and the effective date of this contract was 06 July 2019. | More than 2 ½ years since the scheduled date of awarding and also more than 3 years since the scheduled date of commencement of activities of Package 4 as per the Project Administration | Due to the Covid pandemic outbreak of the country and adverse weather condition, the performance of the | Action should be taken to award the contract without further delay. |

be awarded by 3rd Quarter of 2016 and the activities of the contract were scheduled to be commenced by 4th Quarter of 2017.

Manual.

contractor recorded to be significantly low.

- (c) Reactive power management in the transmission system Improved
 Contract was required to be awarded 1st Quarter of 2017 and the activities scheduled to be commenced by 2nd Quarter of 2018.

Lot 1: Install 100 MVAR Breaker Switched Capacitor at Pannipitiya Grid substation

Contract had been awarded on 9 May 2019 at an estimated cost of US\$ 1.5 million, Euro 3.76 million, Rs. 166.05 million. The activities of the contract were commenced only on 01 August 2019.

More than 2 years since the scheduled date of award and more than a year since the scheduled date of commencement of activities as per the Project Administration Manual.

The effective date was given after fulfilling prerequisites like payment of Advance payment and establishment of LCs. This contract serious of negotiations due to the high difference of the with the estimate and quoted price.

Action should be taken to award the contract without further delay.

Lot 2: Static Var Systems (SVS) at Biyagama Grid substation.

Contract was awarded only on 28 May 2020. The activities of the contract had not Contract.

More than three years than the scheduled date of awarding of Contract.
 The contract was awarded on 28.03.2020,

Action should be taken to award the contract without further delay.

been commenced
on 08 October
2020

but contract
was signed
on
07.07.2020,
and it was
effective
from
08.10.2020.

3.3 Underutilized Resources

| ----- Audit Issue ----- | ----- Management Response ----- | ----- Auditor's Recommendation ----- |
|--|--|---|
| According to the financial targets stipulated in the Project Administrative Manual, it was expected to be utilized US\$ 18 million equivalent to Rs. 2,592 million at the end of the year under review. However, an amount of Rs. 1,103.17 million representing 42.56 per cent of the respective targets had only been achieved as at that date. | Due to the covid pandemic outbreak of the country and adverse weather condition, the performance of the contractor recorded to be significantly low. Due to that the expected project target was not achievable. | Need to adopt with the financial targets stipulated in the Project Administrative Manual. |

3.4 Matters pointed out in Previous Audit Reports which remained unresolved

| ----- Audit Issues ----- | ----- Management Responses ----- | ----- Auditor's Recommendations ----- |
|--|---|---|
| (a) Action had not been taken by the Project to claim the liquidity damages | Liquidity damages had been claimed by Distribution Division 02 during the year 2021, the delay was due to amicable negotiations with the contractors. | Actions should be taken to deduct liquidated damages from the contractors. |
| (b) Inventory balances disclosed in the financial statement of the Project could not be identified in the Provincial stores. | As requested, a report had been forwarded by Distribution Division 02 to the National Audit Office, verifying the inventory balances. | Inventory balances disclosed in the financial statement should be identified. |
| (c) Long outstanding balances of Creditors | The long outstanding balances was cleared by Distribution Division 02, by claiming the liquidity damages, during the year 2021. | Creditors balances should be reconciled periodically. |

3.5 Extraneous Activities

| | Audit Issues | Responses of the Management | Auditor's ecommendations |
|-----|--|---|--|
| (a) | <p>Out of the proceeds of the Loan, the Project had procured 18 motor vehicles at a cost of Rs. 20.3 million during the period from 2016 to 2020 had not been brought to the statement of financial position, as the ownership of the 18 motor vehicles rest were in the name of the contractors. Further, it was observed that no action had been taken by the Project Monitoring Unit to transfer the ownership of the motor vehicles to the Implementing Agency and maintain a data base thereon.</p> | <p>As per the contract agreement and the bidding document of Bid No. CEB/PMU/SESRIIP/2017/ICB/01 these vehicle are to be supplied by the contractor, hence the PMU of SESRI Project (Package 4,5 & 6) have no authority to import or directly purchase vehicles and the approval letter was submitted to the audit and a copy is attached herewith.</p> | <p>Clauses of contract documents should be made for minimizing the risk to the Ceylon Electricity Board.</p> |
| (b) | <p>An Audi Motor Car procured out of the proceeds of the Loan on 28 January 2020 assigned to PMU 3 (Rajagiriya) had not been brought to the statement of financial position, as the ownership is still rest with the contractor.</p> | <p>Those vehicles are bought to financial statements as WIP as at 31.12.2020. Once the project is completed and hand them over to CEB, we can recognize those under PPE of Financial Statements and thereafter we will start the depreciation.</p> | <p>Clause of contact documents should be made for minimizing the risk to the Ceylon Electricity Board.</p> |