

Mahaweli Water Security Investment Programme - Tranche 1 - 2022

The audit of financial statements of the Mahaweli Water Security Investment Programme - Tranche 1 for the year ended 31 December 2022 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 equivalents to Rs. 26,720.80 million and out of that US\$ 150 million equivalents 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 2024.

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 2022, 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 2022		Delay/ Audit Issue	Reasons for delays
	Expected physical performance as at 31 December 2019	Performance achieved		
	Units/percentage	Units/percentage		
i. Construction of Upper Elahera Canal (0+100 km to 6+226 km)	100	64	The contracts had not been awarded within the planned time due to delays in the procurement process. Project period had been extended by 05 years till 30 June 2022 and then 30 June 2024 and could not be able to complete the contracts as per the original plan.	Due to the reason such as additional works and quantity changes, non-planning of the construction properly and delays in land acquisition activities, the project could not be able to stipulated time line.
ii. Construction of Main Canal from Nabadagahawatta Wawa to Mahakithula Reservoir inlet Tunnel (5+250 km to 22+ 460 km)	100	77		
iii. Construction of Mahakithula inlet Tunnel, Mahakithula and Mahakirula Reservoirs, Feeder Canal length 3.3 km from Mahakithula to Mahakirula Reservoir	100	03		
iv. Rasing of crest of Minipe Anicut including water control and Measurement facilities for LB and RD canals	100	82		

Response of Management

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- i. Preliminary designs had to be changed time to time of these contract packages depending on the request from MASL, Irrigation Department and Beneficiaries.
 - ii. In 2019, obtaining explosives became a difficult task due to Easter attack and resulting material shortage such as aggregates, blasting materials for construction work and these were disruptions of transportation resulting labour and mobility issues. During 2020 and 2021 Covid-19 Pandemic situation had resulted labour mobility, material supply etc. slow down the construction process substantially. During 2022 Financial Crisis aggravate this situation with the price increase of construction materials and shortage of fuel and restriction of importation directly effect to the day today works.
As these construction activities had to be carried out with regular water supply to irrigation fields, there were time to time interruptions for the construction work.
 - iii. PMU was able to realize there are certain lands which would have been acquired by Irrigation Department had not been paid compensation at that time since 1986. Because of this whole land acquisition process had to be initiated for the whole segment, during the construction period in North Western Province Canal Project which restricted the activities of the contractor. This was heavily effected to the particular contract even till the end. Even with the above obstacles by now six contract packages have already completed and four packages were still ongoing process and 3 out of 4 contracts will be completed by end of 2023

Auditor's Recommendations

- (i) The action should be taken to get the benefit from the expenditure incurred.
- (ii) Acknowledge in writing to the contractors and the consulting company to complete the contract as soon as possible.
- (iii) The Programme should perform its activities according to the action plan for achieve its targets.

2.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	<p>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 to be charged from the contractor could not be recovered.</p>	<p>Although contractor has filed a case preventing a recovery of losses, Ministry of Irrigation also has taken legal action through the Attorney General Department. Due to the non-appearance of contractor's party arbitration process was terminated by the arbitrator. Even though Mobilization Advance still to be recovered through the legal process. However, contractor is now under liquidating process for which we have applied already requested to be a party on the advice of AG's Dept.</p>	<p>Arrangements should be made to encash the bank guarantees.</p>
(b)	<p>To complete the contract of rising the height of Minipe Anicut including Water Control and Measurement Facilities for Minipe left bank and right bank canal during 2018–2020, had been awarded to a foreign contractor at a price of Rs. 1,864.80 million. Although the contract was extended till 13 July 2021, and then until September 2023, however, the construction progress was only 82.5 percent by the end of the year under review. Due to the delay in completion the contract, the contract price variation was Rs.112.09 million. Further, Rs. 91.27 million had also been paid in excess over the allocated provision to the contractor for additional works and quantity changes.</p>	<p>With regard to the extension of the contract period Amendment Agreement has already been signed with milestones to achieve the target date of completions by September, 2023 does covering the extension had to be granted. The present construction progress is 86% and contractor has mobilized more resources to achieve the target dates of completion.</p>	<p>The remedial actions should be taken to minimize the loss of price escalation and complete the task within stipulated time.</p>
(c)	<p>(i) Construction of main canal from Nabadagahawatta to Mahakitula Reservoir Inlet Tunnel, from 5.25 km up to 22.30 km under the North-Western Provincial Canal Project had been awarded to a foreign contractor to complete during 2018-2021 for Rs. 6,284 million. However, it was later extended</p>	<p>NWPCP-ICB-2- Contract price for Main Canal from Nabadagahawatta to Mahakithula Reservoir Inlet Tunnel was increased due to the scope changes in specifically canal design alignments with the restricted Right of way.</p>	<p>The activities should be planned by considering all factors affected and performed according to the plans for achieve its targets.</p>

till 05 December 2023 and the construction progress was only 77 percent at the end of the year under review. However, Rs. 1,700.84 million more than the amount allocated for the contract had increased.

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| <p>(ii) In order to correct the weaknesses in the original design of the canal contract, more than the planned provision of Rs. 97.52 million had been spent in excess and it had been estimated that the amount would increase by more than Rs. 600 million in future.</p> | <p>The contract price of NWPCP-ICB-2 increased due to increase in quantities of the original BOQ- 9.01%, variation of works – 16.24%, price escalations related land hand over delays/EOT'S – 8.28% and regular price escalations - 65.9%. With the above details maximum percentage of 65.9% occupies the price escalation encounter from March 2022 onwards.</p> | <p>The activities should be planned by considering all factors affected and performed according to the plans for achieve its targets.</p> |
| <p>(d) A consultancy service agreement valued at US\$ 22.09 million had been signed for the Tranche 1 of the programme from 16 November 2015 for a period of 60 months and was extended by 97 months to December 2023. The agreement was amended on 06 occasions due to the extension of the time line. Although, consultancy service fee of US\$ 25.93 million for Tranche 1 and 2 had allocated by the Asian Development Bank, according to the amendments made in 06 occasions, the consultancy service fee had been increased approximately up to US\$ 47.82 million.</p> | <p>Consultancy cost has been increased due to extension time granted for contract. Action to be taken to reduced inputs of both local and foreign experts considering in the reduction of construction activities with ongoing packages. Further action will be taken close RE office within 3 months for NWPCP-ICB-1 package after the finalization and determination. Even the restrictions already been implemented for the allocation of international inputs. New replacement of national staff was recommended with only inputs instead of fulltime assignment.</p> | <p>Immediate action should be taken to minimize the extra expenditure and complete the constructions within the stipulated time.</p> |
| <p>(e) Rs. 85 million was paid to the consultancy firm as monthly consultancy fees including salaries of staff working in the offices belonging to the consultants, established in the Colombo project office and 08 work sites where construction contracts are executed. This cost had been increased due to the payment of consultancy fees on the basis of the project duration. The time line of the construction contracts had been extended and contracts are progressed slowly.</p> | <p>However, Present value is correct. Average to be adjusted</p> | <p>The financial controls should be strengthened.</p> |

2.3 System and Controls

Audit Issue	Response of the Management	Auditor's Recommendation
The commitment charge amounting to Rs. 106.55 million had incurred by the project due to underutilized of allocated fund for the period from 2016 to 2022 as at the end of the year 2022	EOT had to be granted for the construction contracts. Due to the unforeseen and uncontrollable events had been effected not to achieve anticipated targets, as planned. Hence, allocated funds from ADB was underutilized	The financial controls should be strengthened.