

Integrated Watershed & Water Resources Management Project (IWRMP) - 2022

The audit of financial statements of the Integrated Watershed and Water Resource Management Project (IWRMP) 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 provisions in the Loan Agreement No.6621-LK and 6619-LK dated 22 April 2021 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. 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 Ministry of Irrigation is the Executing Agency and Department of Irrigation, Mahaweli Authority of Sri Lanka, Northern Provincial Council Irrigation Department, Eastern Provincial Council Irrigation Department and Water Resources Board are the Implementing Agency of the Project.

The objectives of the Project are to restore the Upper Mahaweli Watershed, strengthen institutional capacity for water resources management and enhance the functionality of water resources infrastructure. Functionally refers to improved safety of dams and improved water distribution networks for irrigation. The activities of the project are implemented under four components namely Watershed & water resource management, Dam safety related infrastructure improvements, Contingency emergency response and project management.

As per the Loan Agreements, the estimated total cost of the Project was US\$ 75.03 million equivalents to Rs. 14,199.43 million and out of that US\$ 69.53 million equivalents to Rs. 13,158.55 million was agreed to be financed by International Development Association. The balance amount of Rs. 1,040.88 million is expected to be financed by the Government of Sri Lanka.

The Project had commenced its activities on 13 May 2021 and scheduled to be completed by 31 October 2025.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2022, statement of 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. Physical Performance

2.1 Physical progress of the activities of the Project

Activity	As at 31 December 2022		Delay/ Audit Issue	Reasons for delays
	Expected physical performance Units/ percentage	Performance achieved Units/ percentage		
To implement 44 major works during 2021 – 2025 period under the provisions of US\$ 49.2 million.	Scheduled to be awarded 64 Packages in year 2022	17 Packages	47 packages out of 64 had not been awarded.	Delay in supply and installation of reservoir dams, canals rehabilitation, improvements, installation of equipment and lifting machines.

Response of the Management

A considerable delay was prevailed due to the following circumstances.

- i. 6 nos. of Contract packages belong to Irrigation Department had been forced to Re-tender.
- ii. Pertaining to the Mahaweli Authority of Sri Lanka major works, 8 nos. of Contract packages have been planned to award and implement in 2022.
- iii. Only 7 nos. of contract packages out of 12 major works were able to award under the Irrigation Department – Northern Provincial Council whereas 10 contract packages from ID-EPC were not awarded due to incomplete of World Bank requirements.

Auditor's Recommendations

Project activities should be preceded as per the procurement plan.

2.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The Mahaweli Authority had awarded the contract to a local company for the execution of 02 contracts valued of Rs. 536.17 million and Rs. 610.44 million (with tax) for the improvements at 02 locations in Walawa Main Canal. Due to construction progress at a poor level of 13 percent and 6.5 percent, these 02	Procedures have been followed to terminate the contract on 28 th April 2023 and forfeited the Advance guarantee, Performance Guarantee and ESHS Guarantee by 22 nd May 2023 pertaining to the Conditions of Contracts. Nonetheless, it was decided to complete the remaining works pertaining to the terminated	(i) The contractor should be black listed. (ii) Should select new contractors according to the World Bank guidelines.

contracts were cancelled by the Mahaweli Authority on 28 April 2023. Relevant advance guarantees and performance guarantees amounting to Rs. 237.91 million had been recovered from the respective banks. Nevertheless, the purpose of accomplishing of the work had not been fulfilled.

contracts by re-tendering. Accordingly, engineering estimates for balanced works have been received by the PMU for re-tendering.

- (b) A contract to install an automatic Geodetic Dam Monitoring Survey System in Kotmale and Randenigala Dams had been awarded to a company in Netherlands for US\$ 1,749,791 equivalent to Rs. 629.92 million by the Mahaweli Authority on 08 August 2022. This contract had been awarded 11 months after the quotations submission and the contractor had requested to increase the value of contract up to US\$ 2,484,969 and to extend the contract period. The Mahaweli Authority had cancelled the contract on 24 February 2023 based on the matters such as non-commencement of contract by the contractor and failure of providing performance guarantees and failure of entering into the contract agreement.
- The procurement procedures have been followed to terminate the contract and forfeit the bid security on 20th March 2023 according to the procurement guidelines. Despite this, it was agreed to retender the above works.
- Should select a new contractor for execution the contract according to the World Bank guidelines as soon as possible.
- (c) Kalawewa Left Bank Canal Gate Repair Contract had been awarded to 02 joint venture companies to be completed within one year at a value of Rs. 177 million. Although the relevant contract had to be completed on 23 January 2023, however the construction progress was at 12 percent at the end of the year 2022, the contract had been extended up to 23 July 2023.
- Since the steel prices skyrocketed during the unprecedented economic crisis, the provision allowed in the contract for the price contingency wasn't sufficient to compensate the price escalation. In addition to that, acute of steels and gear boxes due to import restrictions and dollar shortage were lasted until December 2022 which resulted considerably slowed down the construction work.
- Should take actions according to the instructions given by the World Bank.

- (d) Although it had been planned to carry out 53 per cent of Watershed Management Planning and 41 per cent of Multi Sector Water Resources Planning by the Action Plan of the year under review, those parts of the work had not been done. The provision of US\$ 06 million and US\$ 7.70 million had been made for these entire programmes respectively. These 02 programmes had been implemented under the Dam Safety and Water Resources Planning Project also, which was implemented under the financial facilities of the World Bank during 2008-2018.
- (e) Two contracts valued at Rs. 17.37 million and Rs. 16.81 million had been paid to a consulting firm which had financial weaknesses and losses in the past, for the purpose of preparing environmental and social management plans in connection with 13 lake and canal rehabilitation contracts in the Northern and Eastern Provinces. Out of this, the contract in the Northern Province which estimated Rs. 9.07 million and revised to Rs. 13.3 million later on, had been awarded for Rs. 16.82 million as per the financial proposals submitted by the contractor. Thirteen draft reports had been issued in 02 Provinces and final reports had not been issued by the end of the year under review.
- (f) The approval had been received to cancel US\$ 25 million from the amount given to the International Development Association for expected new activities including supporting the budget as decided by the Cabinet of
- Under Component 1.1, Consultancy service for the Preparation of Upper Mahaweli Watershed Management Plan is being procured through Cabinet appointed Consultant Procurement Committee. Due to various reasons, we could not achieve the expected progress. However, it has been received the cabinet approval on 4 July 2023. In the meantime, there is no any preliminary studies/work done in upper Mahaweli watershed.
- During the evaluation of proposals, CPCM has noted that the original Engineering Estimate is Rs. 9,065,000 wherein provision for the irrigation Engineer/ Water Resources Engineer inputs was not available and did not account for the price escalation and acute of fuel. Hence, the CPCM has suggested revising the engineering estimate. Accordingly, the revised estimate submitted to the Committee on 8th June 2022. Based on the revised Engineering Estimate, Contract Negotiation was carried out and agreed Rs. 16,818,880 due to fuel shortage and uncertainty of market prices at the time of the Contract Negotiation. Eventually, Consultancy Service for Preparation of Environmental Management and Social Management Plan and Environmental & Social Screening Report for Rehabilitate Dams and Canals in Eastern Province was awarded to 20th June 2022 for the amount of Rs. 16,818,880.
- The Ministry of Finance has forwarded a Cabinet Memorandum on Repurposing and Cancellation of ongoing World Bank's projects and decision has been obtained to cancel USD 25. Based on the Cabinet decision, ERD has
- (i) At the preparation of watershed management plan, it should be taken into consideration all the facts which effected to the tasks.
- (ii) Should take action to implement the program quickly.
- (i) Financially viable contractors should be selected.
- (ii) Contracts should be awarded based on engineering estimate has exceeded, the loss should be recovered from the relevant officials.
- Should sign the revised loan agreement and should revise the programs accordingly.

Ministers after the balance sheet date and within the period of presentation of accounts. Furthermore, it had been decided to repurpose more US\$10 million to engage in the necessary activities to alleviate the current crisis situation in the country so that it does not go beyond the development objectives of the Project. In addition, actions were being taken to cancel the local funds amounted to US\$ 05 million currently applied for the Project and to get the funds from the International Development Association instead and the signing of the amended loan agreement including this new situation had not been done even by 18 May 2023.

sent letters to the World Bank requesting to amend the Financial Agreement and currently the World Bank is working on amending the Financial Agreement within a short period.

- (g) The Mahaweli Authority had informed that the requirement of 02 Gantry Cranes for permanent installation of Polgolla and Udawala Reservoir Dams when the preparation of project proposals in the year 2018. Accordingly, the Project had allocated US\$ 2.24 million and according to the quotations presented by the Mahaweli Authority on 24 August 2021, it had been given to a company a sum of Rs.797.61 million to purchase after 07 months. Mahaweli Authority had taken a long time to award the relevant contract as a result, it was impossible to carry out these 02 contracts at the quotation presented and the contractor, had agreed to perform these 02 contracts to the value of Rs. 1,248.37 million and US\$ 1,134,485 in view of the increase in all costs due to the current devaluation of the rupee. Accordingly, the Mahaweli Authority had entered into agreements with the relevant contractor to carry out these 02 contracts by paying Rs. 450.76 million more than the previous price. A sum of Rs.127.32 million equivalent to

The Financial evaluation report was submitted to DPC on 24th January 2022 by TEC, subsequently, the process was hold by the DPC on the instruction from World Bank pertaining to the complaints received from the other bidders on 3rd February 2022. Eventually, the clearance from the world bank to continue the procurement process was received on 20th Feb 2022. After that, under the approval of DPC awarded both contracts to M/S Indo East Engineering & Construction (Lanka) Pvt Ltd on 8th April 2022 by DG, MASL. Since the bids were called on 4th July 2021 and awarded on 8th April 2022 in the midst of unprecedented economic crisis, the contractor refused to acknowledge the LOA without inclusion of Price Contingency and Multiple currencies to the contracts of import of gantry cranes. Since both contracts are very important at the national level Dam Operations Whereby Department of Public Finance issued "No Objection" to amend the contract by including PAC and Multiple Currencies on 10th August 2022. Subsequently, the Secretary, MOI has

Should award the contracts within a short period of time after calling the quotations.

US\$ 206,270 had also been paid by the project as a mobilization advance. During the repair of the existing gates in the reservoir dams of the Mahaweli Authority, the mobile cranes in the head works division of the Authority were being used up to now to lift the gates.

sent a letter requesting to amend the contract rather than rebidding it to the World Bank on 17th August 2022.

As a response to the letter, World Bank has allowed to amend the Contract considering the national requirement. According to the WB instruction, PAC has been included to LKR component, which is subject pay on Price Escalations, in the meantime, import of Gantry Cranes has been offered in USD wherein price contingency was not allowed. Accordingly the contract agreements were signed on 15th November 2022.

- (h) Thus, the progress of the contract for the improvement of Arawatta tank bund belonging to the works of the Irrigation Department that should be completed in the year under review valued at Rs. 46.03 million was 20 percent, the contract had been extended up to 21 June 2023. Similarly, due to the fact that the progress of 03 contracts valued at Rs. 397.31 million for the rehabilitation of the right bank of the Muthiyankaddu Canal belonging to the Northern Provincial Council, which should be completed on 31 December 2022, was in between 30% - 50%, the contract had been extended up to June 2023. Likewise, as the construction progress of 02 contracts belonging to that Provincial Council valued at Rs.81.33 million was at a level of 15% and 40%, its time period had also been extended up to 31 March 2023.

This contract was commenced on 23rd December 2021 where tank bund was planned to rehabilitate by strengthening the tank bund with placing Rip Rap on the upstream slope while constructing toe filter in the downstream slope. The tank was at either full supply level or considerable level during most of the construction period because the ID obliged to issue water for cultivation whereas toe filter at the downstream slope could not be carried out due to delays in the removal of electricity post by CEB. Therefore, ID had to extend the construction period due to unforeseen delays. However, the electricity post was removed, and the current physical progress is 75%. Beside this, 3 nos of Contracts were awarded under the rehabilitation of Muthayankattu Downstream and 2 contracts were awarded for rehabilitation of Pirimanthalaru Scheme and Kanagambikai scheme in December 2021 with a Construction duration of 365 days. However, all the contracts' allowed price contingency was exhausted due to unprecedented price escalation of construction of materials and the physical progress of the packages were slow down due to fuel shortage and prevailed condition of the country at the time.

Actions should be taken to complete the contracts as early as possible.

Following the concurrence of World Bank and approval from the Secretary, MOI Price contingency was increased through Contract Amendment on 27th March 2023. Now the physical progress of the mentioned packages is in a satisfactory level.

2.3 Uneconomical Transaction

Audit Issues

The interest and commitment charges amounting to Rs. 27.2 million had been paid uneconomically for unused 81.73 percent of concessional interest loan which unutilized up to 31 December 2022.

Management Response

Interest charge has to be paid on the withdrawn credit balance under concessional credit A conversion factor referring to rate plus the variable spread or such rate as may apply under non concessional credit. However as per the Financial Agreement, front end fee and Pre Preparatory Facility payments - total of USD 392,385 (66,750+325,635) categorized under non concessional loan. The interest charge of Rs. 27.2 million calculated against on this non-concessional amount of Rs. 78,647,303 (USD 392,385) has been shown in the ERD Financial Report. Accordingly, there is no way to utilize concessional loan savings (of 81.73%)

Auditor's Recommendation

The financial controls should be strengthened.

2.4 System and Controls

Audit Issues

The value of the office equipment used for the project office received from the Dam Security and Water Resource Planning Project implemented under the Ministry of Irrigation and Water Management in the year 2018 had not been evaluated and accounted.

Management Response

Regarding the Assets utilized by the former DSWRP Project, which has not been properly transferred to present IWWRM Project has to be formalized. Accordingly, the Secretary of Irrigation has appointed 4-member committee on 17 February 2023 to conduct the valuation & verification of the said assets.

Auditor's Recommendation

Actions should be taken to evaluated and accounted the assets.