

Road Network Improvement Priority Road Project-2 – 2015

The audit of financial statements of the Road Network Improvement Priority Road Project-2 for the year ended 31 December 2015 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 Loan Facility Agreement No. 4500062212011110472 dated 31 March 2011 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the China Development Bank Corporation (CDB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Facility Agreement of the Project, then the Ministry of Highways, Ports and Shipping, presently the Ministry of Higher Education and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve and rehabilitate 619.72 kilometres of priority roads. As per the Loan Facility Agreement, the estimated total cost of the Project amounted to US\$ 556 million equivalent to Rs.61,438 million and out of that US\$ 500 million equivalent to Rs.55,250 million was agreed to be provided by the China Development Bank Corporation. The Project commenced its activities on 28 June 2011 and scheduled to be completed by 28 June 2014. However, the loan validity period has been extended up to disbursement over.

1.3 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of the financial statements 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 the Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests as deemed necessary to assess the following;

- a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over the Project management and the reliability of books, records, etc. relating to the operations of the Project.
- b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identification of the purchases made out of the Loan etc,
- d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Facility Agreement.
- e) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- g) Whether the financial statements had been prepared on the basis of Sri Lanka Public Sector Accounting Standards.
- h) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- i) Whether financial covenants laid down in the Loan Facility Agreement had been complied with.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Public Sector Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,

- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (d) the financial covenants laid down in the Loan Facility Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) A sum of Rs.1,980 million payable to the contractor as at 31 December 2015 had not been brought to account.
- (b) The rehabilitation works of roads and bridges had been completed at a cost of Rs.71,055 million and handed over to the Road Development Authority as at 31 December 2015. However, those completed works had been continuously shown as the work-in-progress of the Statement of Financial Position as at 31 December 2015.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2015 are shown below.

Source	Amount agreed for financing in the Loan Facility Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	US\$ million	Rs. million		Rs. million	during the year under review		as at 31 December 2015
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
CDB	500	55,250	13,753.00	103.10	13,752	490.18	63,080
GOSL	56	6,188	900.44	-	852	-	7,002
Total	<u>556</u>	<u>61,438</u>	<u>14,653.44</u>	<u>103.10</u>	<u>14,604</u>	<u>490.18</u>	<u>70,082</u>

3.2 Physical Progress

According to the Project Document, it was planned to rehabilitate 504.8 kilometres of national roads and 85.01 kilometres of provincial roads in Nuwara Eliya and Hambantota Districts, 02 flyovers and the widening and reconstruction of 46 bridges on a priority basis

under the allocations made for the Project. It was observed that 532.41 kilometres of national roads and 97.30 kilometres of provincial roads, 02 flyovers and 71 bridges had been completed as at 31 December 2015. The contractor had submitted additional claims of US\$ 10.63 million equivalent to Rs. 1,532 million exceeding the allocations made under the Loan of Rs.500 million.

3.3 Contract Administration

As a common feature, the scope of works under the contract awarded on rehabilitation and improvement of roads and estimated costs thereon had been changed regularly as a result of determination of respective works based on conceptual designs. The instances observed in test checks are described as follows.

- (a) The estimated cost for the rehabilitation and improvement of Tennekumbura - Rikillagaskada - Ragala Road amounting to Rs.7,307 million had been revised subsequently as Rs.9,174 million. However, the approval of the Cabinet of Ministers had not been obtained even at the completion of works under the contract. Further, the Project had approved 04 variation orders valued at Rs.1,002 million for widening of bridges, culverts and construction of retaining walls due to expansion of the width of the road and the road shoulders. In addition, the additional works on reconstruction of an approach road had been carried out at a cost of Rs.12.87 million. The above mentioned additional expenses could have been minimized, if proper ground surveys had been carried out at the designing stage.
- (b) It was observed that the rehabilitation and improvement of Mahiyangana - Dimbulagala - Dalukkane Road had been carried out without proper detailed engineering plans and cost estimates. As a result, the rehabilitation and improvement works had been completed at a cost of Rs.1,746 million, eventhough it was estimated at a cost of Rs.2,202 million. According to the explanations of the Project Director, the contract had been awarded based on the Bill of Quantities prepared on conceptual designs and some of the activities could be curtailed.
- (c) The original estimated cost of Rs. 3,623 million on improvement and rehabilitation of Nagoda - Kalawellawa - Bellapitiya Road had been revised up to Rs.4,122 million, due to additional works and construction of 11 bridges which were not in the original scope of works. Further, the Project had granted extensions for 287 days to complete the works under contract due the additional activities. However, the relevant approvals had not been obtained even as at 31 December 2015 for the variations made over the provisions in the Bill of Quantities for contingencies.
- (d) The original estimated cost of Rs.3,370 million on improvement and rehabilitation works of Badulla - Karametiya - Andaulpotha Road had been revised up to Rs.5,073 million due to additional works. The cost of construction had been increased by 50.53 per cent over the estimated cost due to preparation of the Bill of Quantities based on conceptual design.

- (e) The additional works on rehabilitation and improvement works of Bibile - Uraniya - Mahiyangana Road had been carried out at an estimated cost of Rs.206 million including the improvements of the rehabilitation of access roads and internal roads of Presidential Bungalow at Mahiyanganaya and service roads at Mahiyangana town without obtaining approval of the Secretary to the Line Ministry in terms of Section 8.13.4 of the Government Procurement Guidelines. The rehabilitation and improvement works were completed at a cost of Rs. 185 million and it proved that the cost estimates were not prepared in realistic manner.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) It was observed that the delay charges of US\$ 393,307 and Rs.229.27 million had been paid by the Project as per sub clause 14.8 of the condition of the contract, due to late settlement of bills presented by the contractors.
- (b) According to the Clause No. 1.2.1 Consultancy Services Manual-2007 of the National Procurement Agency, the consultants should be recruited separately for each project. However, the services of the Consultants appointed for the Road Network Improvement Priority Road Project- 03 had been obtained by this Project. The consultancy fees aggregating Rs..95.55 million as at 31 December 2015 had been charged to this Project without being segregated on the services rendered for each project.
- (c) Out of the proceeds of a Loan obtained by the Road Development Authority, a sum of Rs.1,100 million had been allocated to carry out activities under the Project. However, the arrangements made for the repayments thereon had not been explained for audit.