

Northern Road Connectivity Project - 2019

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The audit of financial statements of the Northern Road Connectivity Project for the year ended 31 December 2019 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 the Section 4.05 of Article IV of the Loan Agreement No.2639-SRI and Section 2.09 of Article II of the Loan Agreement No 2639/2640 (SF) SRI dated 27 August 2010 and Section 4.04 and 4.05 of Article IV of the Loan Agreement No 2890 (SRI) SF and 2891 (SRI) dated 19 November 2012 entered into between the Democratic Republic of Sri Lanka and the Asian Development Bank. My comments and observations which I consider should be report to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreements, then Ministry of Ports and Highways, presently the Ministry of Highways is the Executive Agency and the Road Development Authority is the Implementing Agency of the Project. The Road Development Authority is responsible for the management and coordination of Project activities at the national level. The objectives of the Project are to rehabilitate and improve 170 kilometers and 80 kilometers approximately under the additional loans of national roads in the Northern and North Central Provinces. As per Loan Agreement, the initial estimated total cost of the Project amounted to US\$ 146 million equivalent to Rs. 16,790 million and out of that US\$ 130 million equivalent to Rs. 14,950 million was agreed to be financed by the Asian Development Bank. Further, the Asian Development Bank had agreed to provide US\$ 68 million equivalent to Rs. 8,840 million under the additional financing Loan Agreement No. 2890 SRI (SF) of 12 November 2012, out of which US\$ 34 million equivalent to Rs. 4,420 million had been allocated to Provincial Road Development Authorities of the Northern Province and North Central Provinces. In addition, US\$ 30 million equivalent to Rs. 3,900 million had also been allocated by the Asian Development Bank under the Loan Agreement No.2891 SRI of 12 November 2012 to national roads highways in the Northern and North Central Provinces. The Project commenced its activities under the initial Loan Agreement on 22 October 2010 and had been completed by 31 December 2016. The activities of the Project under additional financing arrangements were commenced on 13 May 2013 and scheduled to be completed by 31 December 2018 then extended up to 31 December 2019.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 2.1 of my report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019, financial performance 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 this 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.

In preparing the financial statements, management is responsible for assessing the Project ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

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 skepticism 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

The following observations are made.

No	Accounting Deficiencies -----	Impacts -----	Responses of the Management -----	Auditor's Recommendations -----
(a)	The Northern Road Connectivity Project was operating in the of the Sethsiripaya building with other three Project, The overhead cost amounting to Rs.3.71 million such as electricity, telephone water, office rent and cleaning services had been fully accounted under the Northern Road Connectivity Project without being apportioning among other three Project.	The total Project cost had been overstated by un allocated cost.	There are 4 projects implemented in the same office established for NRCP. Most of the resources are owned to the NRCP. Although the correct method is allocating general expenses among the projects, we face difficulties when applying same practice as follows. These difficulties were explained in the answers for the audit quarries 2018 in respect of the ECIP and audit quarries 2019 in respect of the TPPF too. Difficulties to get separate original invoices for general expenses on project basis. Ex. We received one invoice for building rents. Difficulties to disburse absorbed expenses portion by using same invoices. Donor not accepted duplicate or copy of the documents.	Overhead cost of the Project should be segregated among the Project to reflect the accurate cost of such Projects separately.
(b)	The Project Monitoring Unit of this Project is responsible to monitor the activities of other 3 Projects as well and the Project incremental expenses aggregating to Rs.32.27 million incurred commonly for all Project had been charged as cost of this Project. without being apportioning such costs	The total Project cost had been overstated by un allocated cost	Answer is same as (a) above. However, I would like to explain the matter as follows. As per the schedule 01- page 11 of the financial statement 2019, incremental operational cost was Rs. 32,237,872.65. This included Rs. 23.81 Mn as remuneration of the staff and Rs. 5.4 Mn vehicle hire charges. Balance Rs. 3.41 Mn included other Miscellaneous expenses. These expenses are relevant for all the projects monitoring under this PMU. Staff of the NRCP only handling activities of other 3 projects and difficult to	Overhead cost of the Project should be segregated among the Project to reflect the accurate costs of such Projects separately.

proportionally to other Projects.

apportion such cost Rs 23.81 Mn among other projects because it cannot be reimbursed. In the same scenario balance cost of the PMU also charged to the main project.

- (c) According to the journal entry no 19-116, a sum of Rs.40 million payable to the contractor as at 31 December 2019, had been disclosed as 37.93 million in the Financial Statements.
- Accrued expenses had been under stated by Rs.2.07 million in the financials statements.
- Agreed. This was occurred when clearing of accrual account during final accounts stage year 2019. Cumulative balance of the accrued expenses as of 01.01.2019 was Rs. 146,230,006.77 nevertheless it was set off during the year 2019 Rs. 148,651,119.80. Over accounted was Rs. 2,071,113.03. Carry forward balance of the same account was under stated by Rs. 2,071,113.03. When preparing the schedules, it was adjusted from the accrued amount of M/s Tudawe Brothers – CP 24 mistakenly. Calculation and reconciliation statements of the accrual expenses account are annexed.
- This was noted to correction of the relevant account when preparing final accounts 2020.
- It should be corrected in the relevant ledger accounts.

2.2 Non- Compliance with Rules and Regulations

The following observations are made.

No	Reference to the Rules and Regulations	Non –Compliances	Impacts	Responses of the Management	Auditor’s Recommendations
(a)	Financial Regulations 134(3) and Management Audit Circular No.5 of 26 July 2010.	The transactions of the Project had not been subjected to audit of Internal Audit Section of the Road Development Authority.	Monitoring mechanisms over the activities of the Project is remain weaken	Since the project was intended to close by end of 2019, the Internal Auditor was not recruited	The transaction of the Project should be audited by the Internal Audit Section of the Road Development Authority.
(b)	Financial Regulations No 756	The board of surveys on property, plant and equipment of the Project procured at a cost of Rs.105.6 million had not been carried out during the year under review and	Possible usage of other purposes, misuses and damages.	The board of survey was commenced in December 2019 and there was a delay in concluding due to year end account closing etc. We urge to complete within the 1 st quarter of 2020, however the situation due to COVID-19	Need to adopt with instructions given in the Financial Regulations
(c)	Treasury Circular No 842 of 19 December 1978	Fixed Assets Register had not been maintained by the Project.	Possible usage of other purposes, misuses and damages.	Not respondent.	Need to adopt with circular instruction

3. Physical Progress

3.1 Physical progress of the activities of the Project

According to the information received, the rehabilitation works of 170 kilometers of sections of 06 national roads in Northern and North Central Province awarded under 10 packages including 03 years performance based maintenance works of 03 rehabilitated national roads had been completed of as at 31 December 2015. Further, the contracts for rehabilitation of other 02 national roads awarded in 2015 and completed in year 2016, by utilizing the savings on rehabilitation of roads under the initial Implementing Plan. In addition, the rehabilitation works of 121.98 kilometers of other sections of 07 national roads in Northern and North Central Provinces awarded under the additional financing arrangements had been completed as at 31 December 2016. Out of the savings of the Loans, a new contract had been awarded on 28 April 2017 to rehabilitate A 009 Kandy Jaffna road section from Rambewa to Medawachchiya (140 + 760 km to 150 + 400 km) of 9.64 kilometers had been completed as at 31 October 2018. further, Project had obtained the approval from of Cabinet of Ministers and Asian Development Bank to rehabilitate Madawachchiya- Horowpathana road (B238) section from 10+000 km to 37 +800 km and awarded two contracts thereon, however rehabilitation works had shown slow progress of 58 per cent and 64 per cent respectively as at 31 December 2019, eventhough the physical progress of 100 per cent were expected to be achieved as at that date. .

3.2 Contract Administration

The following observations are made.

No	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
(a)	The Project had awarded 02 additional contracts of Rehabilitation of Improvement of B 282 Medawachchiya, Horowupothana road section from 10 + 000 km to 23 + 000 km and section from 23 + 000 km to 37 + 800 km to two contractors at a cost of Rs.1,388.22 million in May 2019 and agreed to complete in December 2019, without considering the date of completion of the	Possible overrunning of the cost of contract and cost of the Project	The contract packages CP 23 & CP 24 were proposed to utilize the savings in the loan. The loan extension up to 31 December 2019 was approved on 18 November 2018. Then the procurement of additional contract packages CP 23 and CP 24 were initiated. The contract packages' duration was agreed for 9 months due to lesser scope of works. Many culvert structures had been rehabilitated previously. The bids were invited on 22 Jan 2019 and the contracts were awarded on 26 March 2019.	The action is required to be taken to influence the contractor to complete the works and close supervision needed on construction works.

activities of the Project as at 31 December 2019. Further it was revealed those contracts works had not been completed even the date of audit on 23 June 2020, due to poor performance of the contractors even after being granted time extensions to complete the works.

Commenced the works on 30 March 2019 and intended to complete by end of December 2019. All construction activities would have completed within the loan period and settlement of payment is allowed to pay within the loan winding up period.

Unfortunately, the curfew imposed during April 2019 due to unrest in the country. Also, government restricted the issue of explosive material even for the registered contractors. This situation has affected the construction activities vastly. According to the Conditions of Contract, the contractor is eligible to obtain the extension of time for completion of contract if any disruption of the progress due to any actions taken by government (Subclause 8.5 - Delays caused by authorities). Accordingly, the contracts were approved to complete the contracts by end of March 2020 and early April 2020 respectively by granting extension of time.

Further, the construction activities were affected by COVID 19 epidemic from March to May 2020 and the contractors were compelled to close the site temporarily. According to the delay due to acceptable reasons, the contracts are expected to complete in August 2020. As at today, the CP 23 and CP 24 contract packages have substantially completed on 5 August 2020 and 10 August 2020 respectively

- (b) The cost estimate prepared for rehabilitation and improvement of a A 009 Kandy Jaffna road section from Rambewa to Medawachchiya (140 + 760 km to 150 + 400 km) had been increased up to Rs.24.12 million representing 3.01 per cent over the cost of the contract awarded due to inadequate attention on preparation of cost estimates. Further, 32 items in the Bill of Quantities had been increased over the estimated Quantities of works remarkably ranging from 59.66 per cent to 1845 per cent and paid a sum of Rs.136.63 million excessively over the cost of contract awarded.
- Additional cost incurred. The cost estimate prepared for Rehabilitation / Improvement of A009 Kandy Jaffna road section from Rambewa (Km 140+760) to Medawachchiya (Km 150+400) was Rs 960 Mn. The initial contract amount was Rs 799.55 Mn and final contract amount was Rs 823.66 Mn which is increased by 3% of initial contract amount.
- Need to be investigate the reasons and effects on the large difference on payment over the BOQ.
- The estimate is prepared without any detailed investigation of the ground condition. In the civil works, it is unable to exactly predict the underneath behavior of the ground and unforeseen activities and therefore estimate is also prepared with a few conceptual assumptions. Also, this section is affected by inundation at three locations and provided adequate measures to prevent erosion. The soft ground treatment and subgrade improvement at these locations are decided at site. Therefore, the quantity variations are commonly allowed in the civil works contract and physical contingency is also provided in the contract. The FIDIC Conditions of Contract, sub clause 13.1 emphasizes that changes to the quantities of any item in the contract do not necessarily constitute a variation.
- Also, it was noted that a bridge in dilapidated condition in the bottom of slab and it was rehabilitated although it was not in the original scope. In addition, the Rambewa and Ikirigollewa towns were improved according to the requests made by respective Pradeshiya Sabha.
- Therefore, the respective items to the above additional works have increased.

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| (c) | The rehabilitation and improvement works of the road from A 009 Kandy Jaffna road section from Rambewa to Medawachchiya had been completed with delays of 233 days. Even though the Project had deducted delay charges thereon aggregating to Rs.39.97 million from the contractor, and subsequently the deducted money had been refunded to the contractor by allowing the time extension thereon. As a result of granting of such time extensions, additional cost of Rs.4.27 million incurred by the Project due to increase of preliminary and general expenditure. | Additional cost have to be incurred. | When the contractor could not complete the works within the accepted contract period, Employer shall deduct the liquidation damages (LD) according to the sub clause 8.7 of conditions of contract. At the time of the payment certification for the last month of the contract period, neither the contractor has completed the works nor obtained extension for the completion of contract (EOT). Therefore, the LD was deducted according to the contract. Meantime the contractor has submitted claim for EOT, and the Engineer and contractor were discussing and requested further information to justify. Once the documentation is completed, the Engineer has sent their recommendation. It was acceptable to the Employer and the approval was granted. Once the contract period is extended by approved EOT, there is no reason to deduct the LD until the expiry of contract period. The contractor is eligible to receive the deducted LD. Accordingly, the payment was made according to the contract. Contractor is also eligible to receive the payment with reference to the contract period provided in the BOQ for the extended period. | Need to comply with the contract agreement. |
| (d) | Eventhough a sum of Rs 2 million had been estimated for Lum Sum payment of the contract agreement under the general expenses, only a sum of Rs 2.63 million paid thereon. As a result, an overpayment on general expenses amounting to Rs 0.63 million had been made to the contractor. | The Project cost would be increased unnecessarily. | According to Audit Query dated 14 October 2020, the quoted amount of Rs 2 Mn is meant for providing following insurances.
Insurance of Works – until end of Defect Notification Period
Insurance for contractor’s equipment – until end of Defect Notification Period
Third party insurance – until end of Defect | The action is required to be taken to recover the overpayment |

Notification Period

Workmen compensation – until completion of construction

According to the contract, the insurances are provided for the above time durations and those insurances will expire on the respective dates based on the initial contract period. If the contractor is obtained any EOT, he shall extend the insurances according to the new completion date. In the bid, the contractor provided the rate for providing insurances only for stipulated duration acting to the initial contract period. Also, accepting the EOT means contractor is discharged from cause of delay and the delay falls on Employer. Therefore, the insurance cost for additional duration is payable.

- (e) According to sub clause 4.2 of General Condition of the contract agreement, the costs such as document preparation and bank charges etc. on performance bonds, insurance of the contractors equipment, third party insurance, workmen's compensation insurance, bank guarantees for advance payment presented on contract packages are required to be borne by the contractors themselves. However, contrary to the above requirement, a sum of Rs. 10.05 million had been paid as at 31 December 2019 to the contractors to recover the respective cost on bonds and insurance, as the items in the bills of quantities of the 3 contract packages
- The Project cost would be increased unnecessarily
- The sub clause 4.2 of Conditions of Contract (COC) – Performance Security indicates that the contractor shall obtain (at his cost) performance security for proper performance. This clause refers only Performance guarantee. Other respective subclauses of COC address the submission of insurances without indicating cost.
- The insurances, guarantee, etc. are the measures to share the risk in construction. There is no strict principle to avoid the payment for providing insurances and guarantees. This can be added as a pay item to reimburse the cost thus will make the bidder to reduce his overhead component. On the other hand, the bidder will increase his overhead to include these costs if not provided in the BOQ. There are benefit in providing items in BOQ that the
- When preparing bid documents these items should be clearly defined and included to BOQ.

awarded in year 2018 and 2019.

cost for the extended period could be assessed, the rate is become competitive and the reduced overhead is applicable for new works.

In these contracts CP 22, CP 23 and CP 24, the BOQ provided the pay item for guarantees and insurances as we practiced throughout. The bidders would have considered the reimbursing of incurred cost while preparing bids. Therefore, the payment for performance guarantee, advance guarantee, Insurance of works, Insurance for contractor's equipment, third party insurance and workmen compensating were paid according to the agreed contract agreement.