

Second Integrated Road Investment Program (i-Road II) - 2020

The audit of financial statements of the Second Integrated Road Investment Program (i-Road II) 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 4.03 of Article IV of the Loan Agreements No. 3579 SRI and No.3580 SRI (COL) dated 22 November 2017 and Loan Agreement No.3851 SRI dated 13 November 2019, 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 Program

According to the Loan Agreements of the Program, then Ministry of Higher Education & Highways, presently the Ministry of Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Program. The objective of the Program is to enhance the road accessibility between rural communities and socio economics centres. The long term impact is to increase transport efficiency of national and provincial roads. As per the Loan Agreements, the estimated total cost of the Program amounted to US\$ 1,084.60 million equivalent to Rs. 165,185 million and out of that US\$ 900 million equivalent to Rs. 137,070 million was agreed to be financed by Asian Development Bank. The balance amount of US\$ 184.6 million equivalent to Rs.28,115 million is expected to be financed by the Government of Sri Lanka. The financing plan of the Program consists five Tranches under Multitranche Financial Facility and out of that first two Tranche agreements amounted to US\$ 300 million had been signed with the donor as at 31 December 2020. The Program had commenced its activities on 20 July 2018 and scheduled to be completed by 31 March 2027.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Program as at 31 December 2020 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 Program’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 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 the Program’s internal control.
- 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

Accounting Deficiency	Amount Rs.	Response of the Management	Auditor’s Recommendation
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Contrary to Paragraph 36 of Sri Lanka Public Sector Accounting Standard No.	75.8 million	Noted to rectify it when preparation of	Exchange differences arose in foreign

05, exchange differences arose in foreign operations had not been recognized under net assets of the project.

next year Project operations should be Financial Statements. recognized under net assets of the project.

2.2 Unreconciled Balances

Value as per Financial Statements Rs.	Value as per corresponding records Rs.	Difference Rs.	Response of the Management	Auditor's Recommendation
Rs.27,865.9 million	As per General Treasury Rs.32,895.6 million.	5,029.7 million	The reconciliations will be submitted to the audit, from 2021 onward.	Need to discuss with relevant parties and should minimize the differences
	As per External Resources Department Rs.28,762.7 million	896.8 million		

2.3 Non- compliance with Rules and Regulations

No	Reference to the Rules and Regulations	Non- Compliances	Responses of the Management	Auditor's Recommendations
(a)	Sub Clause 14.6 of the Particular Condition of Contract	The minimum amount of Interim Payment Certificate to be submitted by the contractor was 1.5 per cent of the accepted Contract value. However, 259 instances were observed where the evaluation of Interim Payment Certificates under 50 packages below than the required threshold during the year under review.	The reasons such as Covid-19, adverse weather, material shortages etc. may result in causing additional cost to the contractors. If we adhere to original conditions the contractors' cash flow will be affected, and they will not be able to achieve even lower progress.	It is required to adhere with the thresholds stipulated in the condition of contract in order to minimize the costs, time and undue favours for the contractors.
(b)	Sub Clause 4.2 of the General Condition of the Contract	Although the Performance Securities should be provided by the contactors at their own cost, a sum of Rs.85.64 million had been	The General Condition was amended and that pay item in the BOQ was removed in packages of Eastern, Northern and Western Provinces.	The review of Bill of Quantities needed to be done by the Procurement Specialist and the

	paid to the contractors in Uva Province to reimburse the cost of Performance Securities as at 31 December 2020.		Technical Evaluation Committee, before issuing the bidding documents.	
(c)	Sub Clause 119.1(1), (2) and (3) of Particular Specifications of the Contract	The works, equipment, third parties and properties, Workmen's Compensation and Professional Indemnity had not been insured by the contractors of BT 02 and BT 03 packages as at 31 December 2020.	All Insurance in respect of the particular specifications as stipulated in General and Particular Conditions of Contracts had been submitted by the Contractors.	Steps should be taken to obtain necessary insurances from contractors as stipulated in the contract specifications.
(d)	Supplement 31 to the Section 4.2.3 of the Procurement Manual dated 15 March 2017	Although the maximum time period for procurement actions were 15 weeks for national and international bidding, the procurement actions period for civil work procurements in Northern, Eastern and Uva Provinces had exceeded the standard time period ranging from 25 weeks to 38 weeks.	Procurement activities were planned according to Procurement Time Schedule. However, some activities were got delayed due to reasons beyond the control such as reappointment of procurement committees, extension of bid closing date, bid price negotiation etc.	Procurement activities should be completed within the stipulated time period.
(e)	Construction Industry Development Act No.33 of 2014	Every foreign contractor prior to engage in any identified construction work in Sri Lanka should obtain a temporary registration as a contractor with Construction Industry Development Authority (CIDA). However, it was observed that the Program had not considered the requirement of CIDA registration before awarding of some contracts related to 09 contractors.	CIDA registration requirement is not mandatory for bidding as per the ADB guidelines. Hence, it was not considered during bidding. It was noted, bidders are registered individually in CIDA.	Standardization the contractors should be done before selection of contractors.
(f)	Public Contract Act No.3 of	The bidders of public contracts which value over	Registration requirement of Public Contract Act No. 3 of	The bidders and awarded contract

1987. Rs.5 million should register under Public Contract Act before collecting the Bidding Documents and also should get the contract registration after the contract is awarded. It was observed that the Project had not considered that requirement when evaluating the technical bids of respective bidders.

1987 was considered. However, this cannot be considered as a disqualification criteria in line with the ADB procurement guidelines. should be registered under Public Contract Act.

3. Physical Performance_

3.1 Physical progress of the activities of the Project

No	Components	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Awarding of road rehabilitation works of National and Rural Roads	Although the road rehabilitation works of 340 km of 27 national roads and 3400 km of 1405 rural roads in Northern, Eastern, Uva and Western Provinces were expected to be rehabilitated under 53 packages by the Project according to the initial plan, rehabilitation works of 319.96 km of 27 national roads and 3313.16 km of 1349 rural roads had only been awarded as at 31 December 2020.	Some of the initially selected roads have to be dropped, as those roads, had been improved under other projects. All the remaining Roads had been awarded to date, except 73 km of National Highways in Western Province.	Necessary actions should be taken to comply with the initial plan of the project and achieve the target within the period.
(b)	Completion of rehabilitation works of National and Rural roads.	13 rural roads comprising the total length of 25.05 km only had been completed and handed over to the Road Development Authority as at 31 December 2020. Further, out of balance ongoing road rehabilitations, 39.97 km of national roads and 731.62 km of rural roads only had been	Roads will be handed over once the construction and Performance Based maintenance works have been completed. Further, awarding contracts in Northern Province has to be delayed more than one year due to inadequate Budget allocation. We are	All effort should be taken to achieve intended targets of the program.

completed as at 31 December 2020. Thus, it was represented only 21.93 per cent of the total awarded national and rural road length. certain that we can complete all the roads before expiry of the Loan Period.

3.2 Delays in implementation and completion of activities of the Program

Description -----	Audit Issue -----	Response of the Management -----	Auditor's Recommendation -----
(a) Commencement of civil works of road rehabilitation.	Although the civil works should be commenced by the contractors immediately after the contract packages were awarded, 37 contract packages had been delayed to commence civil works period ranged from 30 days to 203 days. The reasons for such delay were not revealed in the audit.	Until the commencement date is fixed, the contractor can't commence even survey, investigation and design works.	Action should be taken to commence civil works immediately after contracts are awarded.
(b) Procurement of equipment	According to the Procurement Plan and the Program Implementation Plan of the Project, although it was planned to complete bid advertisement in 06 equipment procurements with the estimated cost of US\$ 2,230,000, none of those procurement had been completed even as at 31 December 2020.	It was decided to commence procurement activities after considering the importance of the equipment which is necessary to smooth functioning of the program. Accordingly, equipment requirement was finalized and procurement activity will commence in second quarter of 2021.	Necessary equipment should be purchased on time to smooth functioning of the program.

3.3 Contract Administration

No	Audit Issues	Responses of the Management	Auditor's Recommendations
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(a)	Although the Engineer estimates, bid documents and Bill of quantities should be properly evaluate by the Procurement Committee and Technical Evaluation Committee as per the Government Procurement Guideline, the instances contrary to the above Guideline are given below.		
(i)	The loss of Rs.48.2 million had been incurred by the project as at 31 December 2020 in respect to BA 4 and BA 5 contract packages due to rate discrepancies and wrong interpretation of items in Engineer estimates, bid documents and Bill of quantities.	Evaluated bid price of the contracts BA4 and BA5 were found reasonable. The SCAPC and the TEC evaluated the bids within the provision of the ADB's evaluation guidelines.	Action should be taken promptly by the Program to recover the loss.
(ii)	There were rate discrepancies in several Preliminary Items in between Engineer estimate and Bill of Quantities related to AM 01, AM 02 and AM 03 packages. Over 50 per cent variances aggregating Rs.1,035 million was observed relating to those 03 packages.	The Engineer's Estimate is prepared based on HSR, published by Ministry of Highways. These rates are used for construction work of National Highways. Therefore, the variation of prices in Engineer's Estimate and bids can't be avoided.	Action should be taken to prepare the Engineer's Estimates in a realistic manner.

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| (b) | Although all laboratory, furniture and survey equipment will be reverted to the contractor at the end of the Program as per the Conditions of the Contracts, a sum of Rs. 593 million and Rs.16.23 million had been paid as a lump sum for laboratory, furniture and survey equipment respectively as at 31 December 2020. Thus it may indicate that unusual contract conditions may lead to undue benefits to the contractors. | The reverted assets' residual values lead to reduce the bid values. Further, these items are mostly in unusable or outdated condition at the end of the Contract after using it for more than 2-3 years. | As a general practice, the respective assets are retained by the employer. Therefore, the cost of the contract under this program is required to be reduced, compared with the cost of other contract packages awarded by other donor funded projects. |
| (c) | Six roads in Eastern province included in the Road rehabilitation Progress Report as at 31 December 2020 had not included either in the Facility Administration Manual or under relevant contract packages awarded to the selected contractors. Hence the audit could not confirm whether the ADB and Department of National Planning concurrences had been obtained by the Project for newly added roads. Further, the methods of awarding those contracts and the approvals of changes of scope from the lending agency were not made available. | Actions have been taken to obtain ADB approval. | Scope should be change only after the concurrence of the lending agency and the Department of National Planning. |

3.4 Observations made on site visits

No	Audit Issues	Responses of the Management	Auditor's Recommendations
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(a)	According to the Sub Clause 506.5 (h) of the Standard Specification for Construction and Maintenance of Roads and Bridges (SCA/5) issued by ICTAD, the density of all samples taken from the compacted surface course shall not be less than 97 per cent of the Marshall Density at the	The correction works of KL 04 had not made by the time on 09 March 2021, hence no payment has been recommended by the engineer. However, the corrective actions of KL 113A had been	It should be strictly complied with the Standard Specification for Construction and Maintenance of Roads and Bridges (SCA/5) issued by ICTAD and payments should not be made until

point appropriate to the locations. However, instances were observed where the Asphalt Concrete Wearing Course had not complied with the above standard in Walana – Bekkegama –Horana Road (227) and Bothalawa Road (113A) under KL 04 and KL 06 contract packages respectively.

satisfactorily closed on 01 March 2021. corrective actions have been taken by the contractor.

- (b) Bothalawa rural road (additional) (Road ID 113A) with the length of 4.78 Km under KL 06 package was not included in that awarded contracts and further, it had not been indicated in the progress report for the month of December 2020 of the Project furnished to audit. Thus the method of selection of this road and the contractor for the rehabilitation and the concurrence of the ADB and the Treasury were not made available to audit.

It has been approved by the employer and shown separately in the progress report in January 2021.

The project scope should be change only after the concurrence of the lending agency and the treasury.
- (c) The drains had not constructed either side even critical areas of the road before laid the wearing course in Road ID No. 113A- Bothalawa Road (Additional) under KL 06. Hence it may cause to damage the asphalt layer when earth excavation for drains by using machinery in future. Although the Project had planned to construct a culvert at Chenage 0+990, a single Concrete Hume Pipe had only been laid without concreting around the Hume Pipe area. Further, it was observed that the asphalt layer had already been laid without leaving space to concrete the culvert deck and either side of the deck.

This road was given high priority and hence the Asphalt Concrete surfacing was completed before completion of drains and culverts. The outstanding works are being attended by the Contractor.

Constructions should be strictly complying with the Standard Specifications.

3.5 Extraneous Payments

Audit Issue -----	Response of the Management -----	Auditor's Recommendations -----
Commitment charges amounting to Rs.243.48 million had been paid uneconomically to the Lending Agency on undisbursed proceeds of the loan during the year under review and accumulated commitment charges were Rs.449.51 million as at 31 December 2020.	Payments of Commitment Charges are unavoidable, even though it is an uneconomical payment. But it can be minimized by achieving disbursement targets.	Action should be taken to minimize the unnecessary costs.

3.6 Issues Related to Human Resources Management

Cadre Position -----	No of Posts -----	Response of the Management -----	Auditor's Recommendation -----		
Approved	Actual As at 31 December 2020	No. of vacancies			
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Senior Engineer	6	1	5	Action has been taken to recruitments for the vacant positions in order to mitigate any adverse impact on Project performance. Further, the restrictions on appointing staff outside RDA, has caused substantial delay in making these appointments.	Optimum cadre should be maintained by the program to maximize the performance of the Programme.
Coordinating Engineer	14	4	10		
Project Engineer	28	20	8		
Accountant	4	2	2		

3.7 Issues Relating to the Project Monitoring Unit

No	Key Cadre Position	Period of the service in the PMU	Whether employed in other entities	Employed on contract basis/acting basis	Responses of the Management	Auditor's Recommendations
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(a)	Project Director (Uva)	01 month	Yes (Road Development Authority)	Acting basis	This was appointed on acting basis as a temporary measure and applications had been called for recruitment of a Project Director.	The Project Director should always be recruited on full time basis as per circular instructions.
(b)	Project Accountant	More than 02 years	Works as Accountant in i-Road I program	Acting basis	This appointment had been made as an acting basis as effectively uses the service of Accountant of I Road-1.	The recruitments should comply with the approval of the Management Services Department.

3.8 System and Controls

Audit Issue	Management Response	Auditor's Recommendation
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According to the Facility Administration Manual of the Project and Section 9 of the Management Services Circular No.01/2019 dated 05 March 2019, the Project Steering Committee and the Provincial Coordination Committees meeting in each province should be conducted at least quarterly to oversee, monitor and coordinate project implementation. However, it was observed that both committees meeting had not been conducted accordingly with optimal quorum.	Meetings were not conducted in recent time due to COVID pandemic.	All Steering Committees should be implemented as per stipulated manner.