

China Development Bank Funded Priority Road Project -2 -2018

The audit of financial statements of the China Development Bank Funded Priority Road Project -2 for the year ended 31 December 2018 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. 4500062212011110472 dated 31 March 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation. My comments and observations which I consider should be reported to the Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Highways, Ports and Shipping, presently the Ministry of 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 km of priority roads. As per the Loan 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 financed by China Development Bank. The Project commenced its activities on 28 June 2011 and scheduled to be completed by 28 June 2014. However, the period of the Loan had been extended up to the date of disbursements over.

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 2018 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.

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 Program 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 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

No	Accounting Deficiencies	Impacts	Comments of the Management	Auditor's Recommendations
(a)	Even though the Project had been completed on 22 June 2015, winding up financial statements had not been prepared by the Project as at 31 December 2018.	Actual financial progress may not reflect in the financial statements.	Winding up report was prepared as done in past.	Action need to be taken to prepare winding up financial statements.
(b)	Although the Badulla - Karametiya - Andaulpotha road and the Tennekumbura - Rikillagaskada - Ragala road have been completed and handed over to the Road Development Authority in the year 2014 and 2015, however they have been damaged by floods and re-awarded for renovation at a cost of Rs. 132 million without identifying the scope of the project, mobilization advances amounting to Rs. 19.48 million had been paid to contractors. Although the repairs have not been completed by 31 December, 2018, the advance had been capitalized in the year 2015 without identifying as advance.	Overstatement of work in progress.	The Road Development Authority has requested the contractors to pay an advance for the repair of damaged road sections as the work is urgent and important to ensure public safety and convenience.	The outstanding balance should be recovered from the contractor.
(c)	Cash balance amounting to Rs.56.6 million as at 01 January 2018 had not been brought to the cash flow statement during the year under review. Further, the same amount had been transferred to Extension of Southern Expressway Project on 23 January 2018 without being shown as financing activities in the cash flow Statement.	Unrecorded cash balances could be misuse.	The money cannot be fully utilized due to the DAB and amicable settlement process delays, hence Director General-RDA approved to transfer the remaining balance of Rs.56.6 million to ESEP project.	Each and every transactions need to be recorded in the financial statements.

- (d) As per Journal Entry No.07, net assets value of Rs.145 million relating to seven contracts and credit amount of Rs.13 million relating to three contracts transferred during the year under review with the narration of being accounting asset transferred to the Road Development Authority. However as confirmed by Road Development Authority, there were no any assets transferred during the year 2018.
- Possibility to Those fixed assets Relevant
misuse of have been duly transactions need to
assets due to transferred to Road be recorded at right
lack of Development time.
records. Authority at the time
of works completed
by each project.

3. Physical Performance

3.1 Physical Progress of the Activities of the Project

Audit Issue	Impact	Response of the Management	Auditor's Recommendation
Although the project had planned to rehabilitate 504.90 km of national roads and 85 km of provincial roads, construct 02 flyovers, widen and rehabilitate 46 bridges, but only 514.10 km of national roads and 105.62 km of provincial roads and only two bridges had been completed.	Possibility to incur unnecessary expenditure by the project.	Agreed.	Action should be taken to speed up the balance rehabilitation of roads works.

3.2 Contract Administration

The following observations are made.

No	Audit Issue	Impact	Responses of the Management	Auditor's Recommendation
(a)	The Road Development Authority had obtained two additional loans from two local banks to resolve variation order and Dispute Adjuratory Board issues, so the project failed to manage the funds to achieve the intended objectives of the project. Therefore, outstanding loan balance of Rs. 2,900.06 million had been shown in the financial statements.	Unnecessary project management cost could be arising, due to accepting variation orders subsequently.	Agreed.	In case of future projects, fund management should be within the setout objectives of the project.

- (b) Non-current assets purchased through project funds should be returned to the employer in good condition but there was a difference of Rs.117 million between the assets transferred by the contractor to the Road Development Authority and the fixed assets purchased by the Contractor.
- Possibility to Lab equipment and survey equipment also have been transferred to the Road Development Authority.
- Recognition of the Costs should comply with the Interim Payment Certificates.