

Integrated Road Investment Program (i-Road) - 2021

The audit of financial statements of the Integrated Road Investment Program for the year ended 31 December 2021 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 Agreement No. 3171- SRI (SF) for Tranche- 1 dated 05 November 2014, the Loan Agreement No. 3221- SRI and 3222 SRI (SF) for Tranche- 2 dated 28 May 2015 and the Loan Agreement No. 3325- SRI and 3326 SRI (SF) for Tranche- 3 dated 11 December 2015 and Loan Agreement No. 3610- SRI (SF) for Tranche- 4 dated 15 December 2017 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 the Ministry of Higher Education & Highways, presently the Ministry of Transport and Highways is the Executing Agency and 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 economic centers. 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 was US\$ 906 million equivalent to Rs. 117,780 million and out of that US\$ 800 million equivalent to Rs 104,000 million was agreed to be financed by the Asian Development Bank. The balance amount of Rs.13,780 million is expected to be financed by the Government of Sri Lanka. The financing plan of the program consists of six Tranches under Multi Tranche Financing Facility and out of that 04 separate loan agreements amounted to US\$ 557 million had been with the donor as at 31 December 2021. The Program had commenced its activities on 01 June 2014 and scheduled to be completed by 30 September 2024.

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 Program as at 31 December 2021 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 the 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 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 Program.
- 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	Amount Rs.	Responses of the Management	Auditor's Recommendations
(a)	Although 541 rural and national roads with the length of 2,090.39 km had been handed over to the respective agencies as at 31 December 2021, the cost thereon had not been recognized as assets in line with Sri Lanka Public Sector Accounting Standard 01.	Cannot be ascertained.	The total cost incurred for each road will be known only after the completion of the Performance Based Maintenance period and receiving final payment certificate.	Assets should be recognised in line with Sri Lanka Public Sector Accounting Standard 01.
(b)	Accounting policy with regard to the provisioning of consultancy and civil work expenditure had not been disclosed in the financial statements at the end of the year under review.	Cannot be ascertained.	This accounting policy will be disclosed under the notes to the Project Financial Statement with effect from the succeeding year.	Accounting policy should be disclosed in the Financial Statements
(c)	Contrary to the Sri Lanka Public Sector Accounting Standard No 8, provisions had not been made in the financial statements for payments entitled to the contractors under the decisions of the Dispute Adjudication Board relevant to 08 disputes. The initial cost claim of these disputes were amounted to Rs.431.82 million and the finalized amounts were not submitted to audit.	431.82 million	It is noted to make provision or disclosure in the Project Financial Statements for pending Dispute Adjudication Board decisions from the succeeding year. However, until DAB, Arbitration or Amicable Settlement is completed, it will be not possible to include exact amount due to the Contractor.	Provisions or disclosure should be made in line with the Sri Lanka Public Sector Accounting Standard No.08.
(d)	Though the outstanding mobilization advances from the terminated contract packages had been disclosed as doubtful recoveries under Accounting Policies in the financial statements, it had been understated amount by Rs.100 million in the disclosure.	100 million	It is noted to rectify mistake in next year Financial Statements.	Disclosure should be made in full amount.

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| (e) | The non-cash nature transactions amounting to Rs.1,541.6 million relating to 4 provision balances had not been presented accurately in the cash flow statement in line with the Sri Lanka Public Sector Accounting Standard No.02. | 1,541.6 million | It is noted to present Non cash nature items separately from next year Financial Statements. | Cash Flow Statement should be prepared in line with the Sri Lanka Public Sector Accounting Standard No.02. |
| (f) | Decrease in net book value of the Property, Plant & Equipment had been shown as purchase of Property, Plant & Equipment under investing activities whereas the purchase during the year was amounted to Rs.5.2 million. Further, increase in net book value of the assets transferred to Road Development Authority had been shown as cash outflow under investing activities in the cash flow statement erroneously. | 5.2 million | It is noted to rectify this classification error in the next year Financial Statements. | Cash Flow Statement should be prepared in line with the Sri Lanka Public Sector Accounting Standard No.02. |
| (g) | Although the total expenditure from foreign loans during the year under review was Rs.9,570.57 million as per financial statements of the Program, it was represented in the General Ledger and the External Resources Department as Rs.10,128.95 million and Rs.10,073.05 million respectively. However, the reasons for the difference of Rs.502.48 million between the financial statement and the External Resources Department had not been provided for the audit. | 502.48 million | It is impossible for accurately reconcile the total expenditure accounted in the General Treasury or the Project Financial Statements with ERD disbursement details. | Need to discuss with relevant parties and should minimize the differences. |

2.2 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 value of	Unforeseen situations like COVID pandemic and material shortage adversely impact on	It is required to adhere with the thresholds stipulated in the condition of

the contract. However, 62 instances were observed where evaluation of Interim Payment Certificates under 22 packages below than the required threshold during the year under review.

contractors' cash flow during implementation. Therefore, the Employer has recommended to relax the clause.

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 contractors at their own cost, it was observed that a separate pay item had been made in the Bill of Quantities under Preliminary and General Items to be able to claim to the contractors. Accordingly, a sum of Rs.556.38 million had been paid additionally to the contractors to reimburse the cost of performance securities obtained by the contractors. Further, actions had not been taken to recover that amount from the contractors even up to 31 December 2021.
- This quoted item for providing performance security cannot be reimbursed from the awarded contracts. However, in Northern, Eastern and other upcoming contracts, these items are removed from the BOQ.
- The review of Bill of Quantities needed to be done by the Procurement Specialist and the Technical Evaluation Committee, before issuing the bidding documents.
- (c) Sub clause 108.4 of the Specifications to the Contracts. Although the laboratory equipment and furnishings of the main and field laboratory shall be reverted to the contractor at the end of the Program, Rs.615.22 million had been paid by the program as a lump sum for those items as at 31 December 2021.
- If the RDA need any furniture and lab & survey equipment in future, these conditions will be adjusted to suit that condition. 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.

3. Physical Performance

3.1 Physical Progress of the Activities of the Program

No	Component	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Completion and handed over of road rehabilitation works of National and Rural Roads	According to the updated Facility Administration Manual dated 16 December 2021, the road rehabilitation works of 248 km of National Roads and 3,108 km of rural roads in the Southern, Central, Sabaragamuwa, North Western and North Central Provinces and Kalutara District in the Western Province were expected to be rehabilitated during the period of the Program. However, rehabilitation of 27.43 km length of 4 National Roads and 2,062.96 km length of 537 rural roads had only been completed and handed over to the respective agencies as at 31 December 2021 after lapse of 06 years from the date of commencement of the activities of the Program.	Reasons for lacking to complete the planned length are <ol style="list-style-type: none"> Delays in procurement due to reasons beyond PMU's control such as reestablishment of procurement committees due to government changes and cabinet reshuffle in 2015, 2018, 2019 and 2020. Termination of contracts, Covid 19 impacts & Court enjoining orders. Changes in priority of government's development policy resulted in change in already identified roads under the program. 	Necessary action should be taken to achieve intended targets of the program.
(b)	Awarding of road rehabilitation works of National Roads	Even though it had been planned to rehabilitate 423.11 km of national roads under 09 contract packages, 06 contract packages covering length of 278.11 km had only been awarded as at 31 December 2021 and even the bidding process had not been completed for the rest of 03 contract packages which include 145 km.	Not properly Given.	Necessary action should be taken to achieve intended targets of the program.

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| (c) | Completion of rehabilitation works of National roads. | Out of the awarded Road Management Contracts (RMC) excluding the recently awarded RMC 06 and RMC 07 contract packages, all four contracts under the RMC 01 contract package had reported low progress in between 8.9 per cent to 23.9 per cent comparatively to other contracts as at 31 December 2021. | The reasons such as, COVID 19 pandemic situation, scarcity of materials like cement, blasting materials, few landslides were occurred at three locations in this road section and Adverse weather effect caused to have a low progress of these contracts. | Necessary action should be taken to achieve intended targets of the program. |
| (d) | Completion of balance works of terminated contracts. | As per the terms and conditions in the settlement agreement signed to complete the balance works of 04 terminated contracts through the 100,000 km Rural Road Development Program, the balance works had been agreed to be completed within 15 months from the date of signing the agreement. Even though it had passed 18 months as at 31 January 2022 from the date of signing the agreement, very low physical progress in between 11 to 29 per cent had been reported in these packages. | Most of the Contractors in this project have suffered due to delays in making payments. | Necessary action should be taken to achieve intended targets of the program. |
| (e) | Completion of balance work of terminated contracts. | Even though it had passed nearly 03 years from the date of termination of the contracts, out of 12 terminated contract packages the Program had not taken any action to complete the balance works of 02 contract packages namely G1 and KL 02. | Action will be taken to complete the balance works of those contract packages once the legal proceedings are over. | All effort should be taken to achieve intended targets of the program |

3.2 Contract Administration

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Out of 12 abandoned contract packages, balance works of 6 contract packages had been re awarded to carrying out through this program as at 31 December 2021 and the value of the re awarded contracts had been increased by Rs.4,808.8 million when compared with the original contract price.	Bid prices of these new contracts are higher than the original contracts as the prices of materials have gone up with time. However, the difference between the bid prices will have to be recovered from the Contractors of the terminated contracts, through the Employer's claim.	Necessary actions should be taken to complete the construction without further delay and additional costs.
(b)	A settlement agreement had been signed to complete the balance work of 04 abandoned contracts with the same failed contractor through the 100,000 km Rural Road Development program and also reviewed that the value of such contracts had been increased by Rs.417.6 million when compared with the original contract price.	It was decided to allow the same Contractor to continue the works under 100,000km Rural Road Development Program as the Contractor has agreed to withdraw the court cases and repay the unrecovered advances from the IPC's.	Necessary actions should be taken to complete the construction without further delay and additional costs.
(c)	According to the settlement agreements between the Road Development Authority and the Contractor relevant to the contract packages given to the 100,000 km Rural Road Development Program, both parties agreed to settle the unrecovered mobilization advances through the certified amount of payment for price escalation under new indices and price adjustments for work done, other payments due for work done and from the interim bills. However, it was observed that the unrecovered mobilization advances as at 31 December 2021 relevant to those packages were amounted to Rs.963.26 million.	100,000 km Rural Road Development Program had failed to settle those advances and informed that the work done by the contractor is not enough to deduct the advance payment.	Action should be taken promptly by the program to recover the outstanding balances.
(d)	Unrecovered amount of the mobilization advances relevant to 06 re-awarded contract packages as at 31 December 2021 was amounted to Rs.1,453.09 million. Further, unrecovered mobilization advances amount of Rs.377.07 million	The contractors obtained court injunction to prevent the encashment of advance guarantees for these contracts. The court cases are going on and Road Development Authority will be able	Action should be taken promptly by the program to recover the outstanding balances.

related to 02 terminated contract packages could be an additional cost to the program. to recover Advance payments only after conclusion of court proceeding.

- (e) As at 31 December 2021, 43 disputes had been referred to the Dispute Adjudication Board decisions (DAB) and out of that, the total initial cost claim of the disputes that the DAB decision was favorable to the contractor was amounted to Rs.1,698.73 million. However, payments had not been made by the Program in this regard as at 31 December 2021 except for G2 package which amounted Rs.107.72 million. RDA has taken the decision not to release any approved claims of successfully completed Contracts, if there were any terminated Contracts in iRoad and accountable to the RDA by unrecovered Advance Payments. Therefore, initial cost claim amounting Rs. 695.1 million have not paid to the Contractors even they were entitled. Action should be taken to minimize disputes with the contractors.

3.3 Extraneous Payments

Audit Issues

Interest and commitment charges amounting to Rs.45.54 million had been paid uneconomically to the Lending Agency on undisbursed proceeds of the loan during the year under review and accumulated interest and commitment charges were Rs.1,516.79 million as at 31 December 2021.

**Response
 of the Managements**

If the performance of the Project is good the performance of commitment fees can be minimized and can be kept within the allocated amount of commitment charges in the loan.

**Auditor's
 Recommendations**

Action should be taken to minimize the unnecessary costs.