

## **Inclusive Connectivity and Development Project - 2022**

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The audit of financial statements of the Inclusive Connectivity and Development Project for the year ended 31 December 2022 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 55 of the Project Appraisal Document dated 08 September 2021, entered into between the Democratic Socialist Republic of Sri Lanka and the International Bank for Reconstruction and Development. 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 Project**

According to the Loan Agreements, then Ministry of Highways, presently the Ministry of Transport and Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to provide safe, efficient and climate resilient connectivity and strengthen agricultural supply chains to empower Project communities in selected Districts of Sri Lanka. As per the Loan Agreements, the estimated total cost of the Project was to US\$ 500 million equivalent to Rs. 101,499.6 million was agreed to be financed by International Bank for Reconstruction and Development. As per the Restructuring Paper No: RES51645 dated 19 April 2023, the loan amount reduced to US\$ 150 million equivalent Rs. 54,000 million due to reallocation US\$ 325 million for the Contingent Emergency Response Component (CERC). The amount of US\$ 0.83 million equivalent to Rs.300 million is expected to be financed by the Government of Sri Lanka. The Project had commenced its activities on 03 November 2021 and scheduled to be completed by 31 October 2026.

### **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 2022 and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

### **1.4 Basis for Qualified 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 the Management and those Charged with Governance 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.

### **1.6 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 Project’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 Deficiencies	Amount Rs. (million)	Response of the Management	Auditor’s Recommendation
(a) The expenditure of the total allocation of US\$ 325 million for the Contingent Emergency Response Component of the Project during the year under review had not been disclosed in the financial statement as at 31 December 2022. Further, an accounting basis for segregation of the commitment and interest chargers between Contingent Emergency Response Component and other components of the Project had not been identified.	99,903.27	Accounting a separate entity established for CERC, expenditure relevant for the CERC shown in separate financial statements.	Funding arrangement should be disclosed in the financial statements.

(b)	According to the Section 2.03 the Loan agreement, the commitment charges of US \$ 0.68 million had not been accounted in the financial statements as at 31 December 2022. As a result the loan balance and the work in progress in the financial statements had been understated by that amount.	221.36	Commitment charges associated with the loan has not been incurred as a component of the loan agreement.	Action should be taken to comply with the conditions of loan agreement.
(c)	Interest charges had not been accounted in the financial statements as at 31 December 2022. As a result, foreign loan balance and work in progress in the financial statements had been understated by that amount.	254.06	Interest charges associated with the loan has not been incurred as a component of the loan agreement.	Correct amount should be shown in the financial statements.
(d)	As per the Section 43(a) of Sri Lanka Public Sector Accounting Standard 5, assets and liabilities for each statement of financial position should be translated at the closing foreign exchange rate of the date of the statement of financial position. However, the Parity adjustments relating to the foreign loan of the project had not been accounted for the year under review as per above requirement.	482.00	Parity adjustment is required when loan currency is different to the presentation currency.	Adhere to the Sri Lanka Public Sector Accounting Standards

## 2.2 Non-compliance with Rules and Regulations

No	Reference to the Laws, Rules and Regulations	Non-compliances	Responses of the Management	Auditor's Recommendations
(a)	Section B 2 and 4 of Schedule 11 of the Loan Agreement	The Project should be prepared a Matching Grant Manual compatible with Project Operations Manual within three months after the effective date of the borrowings, However, the Project had not been taken any action to prepare that manual even as at 31 December 2022.	Matching grant component was not finalized within the fiscal year under review.	Adhere to the conditions in the operation manuals.
(b)	Paragraph 9 of the Management Services Circular No. 01/2019 dated 05 March 2019.	Steering Committee meetings of the Project had not been conducted at least once in two months during the year under review.	Project Steering Committee meeting is conducted considering the priority of matters.	Adhere to the Circular instructions.

- (c) Management audit Circular No.02/2016 dated 10 June 2016 Internal audit activities had not been carried out during the year under review. Suitable arrangement will be put in place for internal auditing mechanism. Adhere to the Circular instructions.

### 3. Physical Performance

#### 3.1 Physical Progress of the Activities of the Program

(a) Enhancing Safe and Climate Resilient Transport Connectivity

Component	Activity	As at 31 December 2022		Delay/Audit Issue	Reasons for delays
		Expected physical performance (%)	Performance achieved (%)		
Enhancing Safe and Climate Resilient Transport Connectivity	Rehabilitation, improvement and maintenance of rural road	24.94	11.83	The overall physical progress of the main activities of the Project was 11 per cent against the targeted progress of 21 per cent as at 31 December 2022.	Poor performance of the contractors and fuel and construction material shortages.

#### Response of the Management

Slow progress is mainly due to adverse behavior of the micro-economic factors.

#### Auditor's Recommendations

Maximum effort should be taken to achieve intended targets of the project within the time frame.

(i) Maintenance of rural roads - Rathnapura District

Component	Activity	As at 31 December 2022		Delay/Audit Issue	Reasons for delays
		Expected physical performance (%)	Performance achieved (%)		
Enhancing Safe and Climate Resilient Transport Connectivity	Rehabilitation, improvement and maintenance of rural road	64.42	20.21	A total length of 76.62 km of 22 rural roads in Rathnapura District was expected to be rehabilitated and 49 per cent to 98 per cent of physical progress under four packages was expected to be achieved as per the Project Procurement Plan. However, a length of 7.1 km represented 9 per cent of the total length of the roads only had been rehabilitated with the cost	The fuel and material shortages.

of Rs. 601.1 million. It was represented only 14 per cent to 26 per cent of the physical progress of the four packages as at 31 December 2022. Therefore the risk of completing the rehabilitation activities of the roads within the Project period could not be ruled out in the audit.

**Response of the Management**

It was difficult for the contractors to get the sufficient fuel and blasting material for the construction work due to the economic instability of the country during that period.

**Auditor’s Recommendations**

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

(ii) Maintenance of rural roads - Matale, Anuradhapura and Kurunegala Districts

Component	Activity	As at 31 December 2022		Delay/Audit Issue	Reasons for delays
		Expected physical performance (%)	Performance achieved (%)		
Enhancing Safe and Climate Resilient Transport Connectivity	Rehabilitation, improve maintenance of rural road	22.39	15.31	According to the Project Procurement Plan, the total length of 281.83 km of 63 rural roads in Matale, Anuradhapura and Kurunagala Districts were expected to be rehabilitated during the period of the Project. However, the rehabilitation works of 54 rural roads with the cumulative length of 251.67 km only had been commenced as at 31 December 2022 and it was represented a low physical progress from 1 per cent to 21 per cent. Further, it was observed that a length of 4.5 km representing 1.7 per cent of the total road length only had been completed as at the end of the year under review.	The fuel restrictions and material shortages prevailed in the country.

**Response of the Management**

The adverse impact of the macroeconomic factors has mainly contributed on adverse variation between actual and planned physical progress of these contract packages.

**Auditor’s Recommendations**

Maximum effort should be taken to achieve intended targets of the Project.

### 3.2 Contract Administration

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Consultancy service for rehabilitation improvement and maintenance of 76.62 km of rural roads in Embilipitiya, Pelmadulla and Rathnapura in Rathnapura District had been awarded to the consultancy firm at a cost of Rs.164.84 million. The cost estimate of the consultancy service was Rs. 80.5 million and it represented 104 per cent cost increased with in the Engineering Estimate. However, the Procurement Committee had not analyzed that variance. It was a problematic issue in audit.	The Ministry Consultancy Procurement Committee analyzed the high variance and have negotiated two times and reduced their cost proposal by 36 per cent from the initial submission.	Necessary action should be taken to analyze the cost estimate.
(b)	Although the qualification based procurement method maximum limit was US \$ 0.3 million for selecting the consultancy service, it was observed that this threshold had been exceeded by US \$ 0.2 million in this procurement and the reason for using the said selecting method had not been revealed to the audit.	The thresholds limit had been exceeded USD 0.2 million. However, the negotiated cost proposal had been submitted for bank review and obtained the no objection.	Adhere to the conditions in the Project Appraisal Document.
(c)	A contract had been awarded at a cost of Rs. 19.66 million for the Consultancy Service for Environmental and Social Screening of 200 km of Rural Roads of Hambantota, Monaragala and Puttlam Districts and the contract value had been exceeded by Rs. 3.5 million or 21 per cent with the Engineering Estimate.	The consultant presented his cost proposal taking into account all the difficulties in the country.	Accurate estimate should be made to avoid additional cost.

### 3.3 Underutilized Resources

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	It was observed that the Project had utilized only Rs, 2,241.94 million as at 31 December 2022 out of the total allocation of US\$ 150 million equivalent to Rs. 54,000 million of the project. Slow progress of the ongoing contracts are mainly affected to that poor utilisation of loan funds.	A sum of Rs. 2,712.12Mn was utilized further under retroactive financing and not debited to the vote as per the guidelines.	Loan fund should be utilized effectively.
(b)	According to the financial targets stipulated in the Project Administrative Manual had not been revised after Contingent Emergency Response Component (CERC). Therefore, utilization of funds could not be reconciled with the targets disbursement for the end of the year under review. However, a commitment	Revised disbursement plan was not prepared in fiscal year under review as loan components was not finalized.	Action should be taken to revise the targets according to the new changes.

charge amounting to Rs.221.36 million had been paid by the Project to the Lending Agency as at 31 December 2022.

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| (c) | The Project had utilized only Rs.47.83 million out of GOSL allocation of Rs.70 million under Vote No. 117-2-4-48-2506-0-17 and it was represented 68.33 per cent of the allocation made during the year under review. | Audit Observation is factually correct. | Action should be taken to utilize GOSL allocations effectively. |
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### 3.4 Extraneous Payments

<b>Audit Issue</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
(a) According to Section 22 and Section 33 of the Implementation Arrangements and Support Plan of the Project Appraisal Document, the World Bank delegation agreed to reimburse the eligible expenditure already made during the period of 12 months from the Loan Agreement date for the 100,000 Km Rural Road Development Program up to US \$ 75 million. However, US \$ 10.89 million equivalent to Rs. 3,949.43 million only had been reimbursed due to inability of adherence to the World Bank's requirements. Thus it was observed that 14.52 percent only had been utilized out of total allocation under the retroactive financing.	Expenses paid by the 100,000 Km Program within retroactive period had been scrutinized and claimed under this component.	Action should be taken to utilize allocations as per the stipulated requirements.
(b) It was observed that, Retroactive Reimbursement Rs. 3,949.43 million had been recorded as a working progress expenses without directly contribute to the Project objectives.	Project has reported relevant expenditure in work-in-progress.	Correct Project cost should be shown under WIP.

### 3.5 Matters in Contentious Nature

<b>Audit Issue</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
<b>Activation of the Contingent Emergency Response Component (CERC) under the Project</b>		

According to the letter dated 09 May 2022 of the Secretary to the Treasury and the subsequent letter sent by the Country Director of the World Bank dated 18 August 2022, an amount of US \$ 325 million had been allocated for the Contingent Emergency Response Component of the Project. The CERC funds had been allocated to minimize the impact of the economic crisis and restore social stability by providing immediate needs

and essential items and social protection .Following observations are made in this regard.

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| (a) | Approval of the Cabinet of Ministers had not been obtained for the changes of the initially approved scope of the Project.                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | Separate restructuring paper has been circulated.                                                                                                                | Action should be taken to obtain cabinet approval.                               |
| (b) | The activities of the Project are implemented under 2 components namely Enhancing Safe and Climate Resilient Transport Connectivity with an estimated cost of US\$ 450 million and Enhancing Supply Chain and Access to Service for Farmers with an estimated cost of US \$ 50 million. After activation of the CERC component of the Project, the initial change of the Project has to be changed. However, the scope change of original activities had not been identified properly up to April 2023. Further, it was observed that Project scope had been changed without realistic basis. | Project scope has been changed with the activation of CERC on the request of Secretary to Treasury and the restructuring papers had been approved on 19/04/2023. | Proper feasibility study should be conducted before implement the Project.       |
| (c) | After the CERC activation of the Project, initial allocation of the loan had been reduced from US \$ 450 million to US \$ 150 million for the component 1 of the Project. However, the allocation for the component 2 of the Project had not been finalized even up to 31 December 2022.                                                                                                                                                                                                                                                                                                      | Component 2 is being discussed extensively and included in the restructuring paper.                                                                              | Immediate action should be taken to finalized the Project component.             |
| (d) | After limitation of the Scope of the Project, the Loan Agreement, Project Development Objectives, Project Results Framework, Implementation Arrangements, Disbursement Targets and Conditions, Environment and Social Framework should be change accordingly. However, the Project Appraisal Document had not been revised accordingly as at 31 December 2022. It may be badly affect to the proper progress in future.                                                                                                                                                                       | Revision of project appraisal document to be carried out with the collaboration of funding agency.                                                               | Action should be taken to revise Project Appraisal Document as per the revision. |



### 3.6 Issues Related to Human Resource Management

Cadre Position	No of Posts			Response of the Management	Auditor's Recommendations
	Approved	Actual as at 31 December 2022	No. of vacancies		
Senior Engineer	5	3	2	Project has maintained sufficient cadre in accordance with the project life cycle.	Optimum cadre should be maintained to maximize the Project performance.
Senior Procurement Specialist	1	-	1		
Procurement Engineer	2	-	2		
Environmental Specialist	1	-	1		
Social Safeguard Specialist	1	-	1		