National Highways Sector Project - 2013.

The audit of the financial statements of the National Highways Sector Project for the year ended 31 December 2013 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 34 of Schedule 6 of the Loan Agreement No. 2217 SRI dated 14 December 2006 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Highways (MOH) presently Ministry of Highways Ports and shipping (MHP&S) and the Road Development Authority (RDA) are the Executing and Implementing agencies of the Project. The objectives of the Project are to improve the National Highways Network efficiency and strengthen Road Sector Institutions. Further, the Project shall,

(i) improve road sector institutions,
(ii) upgrade project roads; and
(iii) develop pilot performance based maintenance contracts.

As per the Loan Agreement, the estimated total cost of the Project is US $208 million equivalent to Rs. 21,181 million and out of that, US $ 150 million equivalent to Rs. 15,275 million was agreed to be financed by the Asian Development Bank. A Memorandum of Understanding (MOU) was signed by GOSL with ADB on 15 February 2008 and Loan Agreement had been amended accordingly on 27 May 2008 to change the scope of the Project within the original loan amount. In addition to the above Loan, another Loan Agreement No. 1355P had been signed by the GOSL with OPEC Fund for International Development (OFID) on 04 October 2010 and agreed to be allocated US$8 million equivalent to Rs. 880 million by the OFID. A supplementary Loan Agreement No. 2767 –SRI had also been signed by the GOSL with ADB on 04 October 2011 to allocate US $ 85 million equivalent to Rs. 9,350 million. The financial statement for the year ended 31 December 2013 for allocations made under the supplementary Loan Agreement had been furnished separately. As per the initial Loan Agreement, the Project activities had been commenced on 07 April 2006 and was scheduled to be completed by 31 December 2012. The financing activities of OFID will be closed on 30 June 2015. However, the activities carried out under the supplementary Loan Agreement was scheduled to be completed by 30 June 2016.

1.3 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies and making accounting estimates that are responsible in the circumstances.

2. Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides reasonable basic for my opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

(a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over the Project management and the reliability of books, records etc. relating to the operations of the Project.

(b) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the lending agencies, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identifications of purchases made out of the Loans etc.

(c) Whether withdrawals under the Loans had been made in accordance with the specifications laid down in the Loan Agreements.

(d) Whether the funds, materials and equipment supplied under the Loans had been utilized for the purposes of the Project.

(e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.

(f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.

(g) Whether the opening and closing balances, withdrawals from and replenishments to the Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL), as at that date.

(h) Whether the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreements,

(i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(j) Whether the financial covenants laid down in the Loan Agreements had been complied with.

3. Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 5 of this report, I am of opinion that,

(a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles,

(b) the funds provided had been utilized for the purposes for which they were provided,

(c) The withdrawals under the Loans had been made in accordance with the specifications laid down in the Loan Agreements.

(d) the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreements,

(e) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(f) the financial covenants laid down in the Loan Agreements had been complied with.

4. Financial Statements

4.1 Financial Performance

According to the financial statements and information made available, the Project expenditure for the year ended 31 December 2013 amounted to Rs.1,607. million and the cumulative expenditure as at 31 December 2013 amounted to Rs.25,322 million. The following statement shows a summary of the expenditure for the year under review, the expenditure for the previous year and the cumulative expenditure as at 31 December 2013.

Description	**Expenditure for the year ended 31 December**		**Cumulative Expenditure as at 31 December 2013**
	2013	**2012**	
	Rs	Rs.	Rs.
Fixed Assets- at cost	-	582,942	9,343,881
Work Completed			
Works	21,301,740,878		21,301,740,878
Consultancy	860,175,817	-	860,175,817
Land Acquisition and Resettlement Cost	1,157,219,220	-	1,157,219,220
Project Management Expenditure	945,757	62,242,975	364,907,493
Highway Upgrading			
* Land Acquisition	(1,123,676,454)	(455,502,746)	1,031,098,732
*Civil works	(20,727,048,132)	4,936,067,684	-
* Construction Supervision	(860,175,817)	72,977,250	-
Construction of Highways Secretariat	408,988,696	741,893,462	1,638,671,863
Performance Based Maintenance	-	78,863,519	-
Financial Charges	-	162,340,389	-
Net Current Assets	588,601,674	(1,438,491,103)	(1,041,243,559)
Total	1,606,771,638	4,160,974,372	25,321,914,324

* Note : Working Progress expenditure had been transferred to the Civil work expenditure.

5. Audit Observations

5.1 Accounting Deficiencies

According to the final bill of the Puttlam – Trincomalee Road section from Puttlam to Nochchiyagama the outstanding balance of ICB-01 contract was Rs. 3,558,841, whereas the balance as per payable account of the Project had shown as Rs. 10,022,023. The Project had not reconciled the difference of Rs. 6,463,182 in the account.

6. Financial and Physical Performance

6.1 Utilization of Funds

According to the initial Loan Agreement, the ADB and OFID had allocated US $ 158 million to carry out the improvements and rehabilitation works of five national roads for the length of 270 km, construction of a building for Highways Secretariat and pilot programme on performance based road maintenance works . As per amendments made on 27 May 2008, the scope of the works had been changed within the original allocation. According to the information received from the Project, the funds allocated by the lending agencies under each component and utilization thereon as at 31 December 2013 are given below.

Activity	Allocations made		Amount utilized/disbursed as at 31 December 2013		
	ADB	OFID	Foreign Loans		GOSL
	US $ ('000)	US $ ('000)	US $ ('000)	Rs ('000)	Rs ('000)
Civil works					
- Road upgrading	125,359	8,000	133,359	15,325,817	4,234,873
- Performance Based Maintenance	2,514		2,514	288,675	34,995
- Building Construction	8,535		8,535	1,026,148	402,712
Land Acquisition & resettlement	-	-	-	-	2,188,318
Consulting Services					
- Institutional and policy support	273		273	31,058	
- Construction supervision	6,441		6,441	728,151	106,389
Project Management	1,875		1,875	214,949	153,880
Interest and commitment charges	5,003		5,003	585,949	-
Total	150,000	8,000	158,000	18,200,747	7,121,167

According to the above information, the funds amounting to US$158 million equivalent to Rs. 18,201 million allocated by the Lending Agencies had been fully utilized as at 31 December 2013. As per information made available by the Project, the improvements and rehabilitation works of all five national roads had been completed and handed over by the respective contractors as at 31 December 2013. However, payables aggregating Rs. 1,023.66 million had remained unsettled as at 31 December 2013 to the contractors engaged on improvements and rehabilitation works of the roads mentioned above. Further, total allocation of US $ 8.54 million equivalent to Rs.888.15 million made by the ADB for building construction purposes had been fully utilized by the Project as at 31 May 2013. Therefore, additional expenses incurred due to variations of the original scope of the works would have to be incurred by the GOSL.

6.2 Contract Administration

Following observations are made.

The contract for the construction of the Building for Highways Secretariat had been awarded to a private party at a cost of Rs. 599.30 million on 17 August 2010 to complete first three levels, out of all eight levels of the building and was expected to he completed the construction of first three levels before 04 November 2011. However, at the time of completion of 90 % of such construction works, the PMU had taken action in December 2011 to award the contract for construction of other five levels to the same contractor at an additional cost of Rs.568.14 million as a variation made to the first contract. Further, the PMU had decided in June 2012 to extend the building for further two levels at an estimated cost of Rs.795.72 million. Therefore, the total anticipated cost of the building comprised with all ten levels was Rs. 1,963.17 million as at 31 December 2013. The approval of the Cabinet of Ministers for the first variation had been obtained on 11 July 2013 to incur the additional cost from local contribution. Following observations are made in this regard.

(a) As per progress report of the Consultant for the month of February 2013, the works of all ten levels of the building was substantially completed. However, the approvals had not been obtained for the scope variation for the extension of further two levels and cost and time extension granted thereon as per paragraphs 4.3.2 and 8.13.4 of the Government Procurement Guidelines. Further, the contractor had mutually agreed with the PMU to continue the construction works and no written agreement or MOU had been signed thereon even as at 31 December 2013.

(b) Although the contractors had submitted bills for Rs.242.70 million from December 2012 to May 2013 those bills had not been settled even up to 31 December 2013. This delay will cause to pay interest to the contractor in the ensuing year.

(c) According to the specific condition included in the Contract Agreement, the Contractor had agreed to determine 15 percent profit margin on overhead cost. However, instances were observed that 25 per cent profit margin, had been claimed contrary to the above condition.

(d) According to the letter No C/369/10/HSB-HO/2013 of 17 November 2012 of the Contractor, of the Contractor had agreed not to claim additional amounts over the amount agreed for Stage -3 of the Construction. However, additional amount aggregating Rs.6.14 million had been claimed on retained workers and material at sites and transport charges etc. and had been paid accordingly.

(e) Regular changes of the scope of the construction works had allowed rooms to apply different rates for the claim made by the contractor. Therefore differences ranging from 13 percent to 68 percent applied for additional works had been carried out under Stage – 3 of the construction.

(f) The space for the car park had not been planned to provide within the building and additional location would be required. Further, additional cost would be incurred for that purpose.

(g) The construction works of the building was expected to be completed initially on or before 30 November 2012 and it was extended up to 30 November 2014 by allowing time for completion of additional two levels. The physical progress of such works at the end of February 2014 was on average 60 per cent. It was further observed that the contractor had not employed the sufficient laborers and equipment as enable to complete the works on due dates. However, payments amounting to Rs.59.54 million had been made as at 31 December 2013 for price fluctuations.

7. <u>Human Resources Management</u>

Following observations are made**.**

(a) The staff of the Project office had comprised with 21 members at the end of the year under review even though 35 cadre positions had been approved by the Department of Management Services of the General Treasury. However, 14 vacancies for the posts within the approved cadre including key posts such as 03 Senior Engineers, 01Engineer (Bridge Designing), were remained unfilled at the end of the year under review. Further, 07 employees including 02 Consultants and 2 clerks and a system analyst had been deployed and paid Rs. 3,158,130 by the Project for the positions which were not approved by the Department of Management Services.

(b) According to section 2.2.4 of the circular No.33 dated 05 April 2007 of the Department of Management Service, appointments to all posts including project core staff should be made only after calling for applications by open advertisements followed by interviews. However, the Project had not applied such procedures.

(c) According to the section 2.2.7 of the above Circular, all appointments should be made on contract basis for a maximum period of three years renewable annually subject to satisfactory performance. However 34 staff members of the RDA had been employed by the Project ,on temporary basis contrary to the above requirement. Further, as a practice, the Project had recruited officers of RDA on secondment basis and release them to other Project in order to continue financial and other benefits to them under the Projects.

(d) The Project had paid additional expenditure such as overhead expenses, Value Added Tax and Nation Building Tax amounting to Rs.420,903 , Rs.51,539 and Rs,8,590 respectively on behalf of the Gratuity payments made to them.