

Northern Road Rehabilitation Project (Rehabilitation of 67 kilometres of Navatkuli-Karaitivu-Mannar Road) - 2014

The audit of financial statements of the Northern Road Rehabilitation Project (Rehabilitation of 67 kilometres of Navatkuli-Karaitivu- Mannar Road) for the year ended 31 December 2014 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. This Project is implemented as per the Loan Agreement No. BLA 201111 dated 29 April 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the Export-Import Bank of China.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Ports and Highways presently, the Ministry of Higher Education 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 rehabilitate 67 kilometres of Navatkuli-Karaitivu-Mannar Road. As per the Loan Agreement, the estimated total cost of the Project is US\$ 56.9 million and out of that US\$ 48.3 million or 85 per cent was agreed to be financed by the Export-Import Bank of China. The preliminary works of the Project was commenced on 10 November 2011 and scheduled to be completed by 09 May 2014. The activities of the Project had been substantially completed on 12 May 2014 and handed over to the Road Development Authority.

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 Sri Lanka 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.

1.4 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests 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 Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) 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 Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loan.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipments supplied under the Loan had been utilized for the purposes of the Project.
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (g) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (h) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (i) Whether the financial covenants laid down in the Loan Agreement had been complied with.

1.5 Basis for Qualified Audit Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 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 2.2 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purpose for which they were provided,
- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and;
- (d) the financial covenants laid down in the Loan agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

A special Loan of Rs.23.99 million obtained during the year under review from the Road Development Authority had not been separately recognized and disclosed in the financial statements.

2.2.2 Non - Compliance with Laws, Rules and Regulations

The following instances of non- compliance highlighted in my previous audit report had been continued even during the year under review without taking remedial actions.

- (a) Recovery of overhead cost amounting to Rs.758,439 by the Road Development Authority and payment of bonus and medical allowance of Rs. 629,104 to the staff of the Road Development Authority attached to the Project, contrary to the Sections 8.3.9 and 8.6 of the Circular No. PED/12 dated 02 June 2003 of the Department of Public Enterprises.
- (b) Application of formula introduced by the Road Development Authority to calculate remuneration of the staff of the Road Development Authority attached to the Project, contrary to the Circular No.33 of 05 April 2007 of the Department of Management Services.

3 Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed for financing according to the Loan Agreement		Funds utilized			
			during the year 2014		utilized up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
Export-Import Bank of China	48.3	6,532.5	22.92	2,996.71	42.55	5,490.26
GOSL	8.6	1,289.8	0.40	52.92	8.98	1,226.18
	56.9	7,822.3	23.32	3,049.63	51.53	6,716.44

3.2 Physical Progress

It was observed that the rehabilitation and reconstruction works of the Road had been completed as at 31 December 2014. However, it was observed at the site visits made by the auditors that necessary accesses had not been provided to the by – roads at the right hand sides of Jeyapuram junction at 51.2 kilometre and Moonrampiddy junction at 67.5 kilometre of the Road. Further, Chevron road sign board had not been fixed at the dangerous curve in Mulankaavil junction. In addition, 03 bridges at Mandaikkullaru, Paliyaru and Kalliyadi had not been reconstructed as such works were not identified at the initial level.

3.3 Contract Administration

The following observations were made in this regard.

- It was observed that many of the outstanding works and defects identified during the substantial completion stage had been completed at the end of the defect liability period. As a result, the defect liability period had been extended by 6 months up to 15 November 2015.
- According to the Clause 13.6 of the Condition of Contract, the variations shall be executed on a day works basis for works in minor or incidental nature and

provisions amounting to Rs.729,900 had been made in the Bill of Quantities thereon. According to the Statement of Completion submitted by the contractor, variation of works valued at Rs. 1.68 million representing 231 per cent of initial allocation had been claimed under day work basis, exceeding the above provisions. Further, it was revealed that many of such works were not minor or incidental in nature and formal variation order had not been raised for these variations.

- (c) Eventhough the defect liability period of the contract was ended on 04 September 2014, a part of retention money amounting to Rs.163.31 million had been released by the Project on 26 June 2014 by accepting a bank guarantee, contrary to the Clause 14.9 of the General Conditions of the Contract Agreement.
- (d) According to the provisions made by the contract agreements, the assets procured and used by the civil contractors or Consultants out of funds provided by the Projects are required to be considered as the assets of the Project. However, the value of assets such as vehicles, equipment, furniture etc., procured by the contractors, out of Loan proceeds had not been recognized separately and brought to the records of the Project.

3.4 Transaction in Contentious Nature

The following observations are made in this regard.

- (a) According to the final Interim Payment Certificate made on 15 May 2014, the total cost of the contract amounted to Rs.1,311.69 million eventhough a sum of Rs. 1,871 million had been estimated in the Bill of Quantities. This indicated that the realistic estimates for the rehabilitation works of the Road had not been done and the mobilization advances amounting to Rs. 168 million had been overpaid based on unrealistic cost estimates.
- (b) It was observed that the detailed investigations on road works had not been carried out at the design stage. As a result, it was realized subsequently that several sections of the Road were flooded during the rainy seasons and as a remedial action, the variation orders valued at Rs.527.5 million had been issued to embank the sub base of the Road, Further, the width of the Road had been reduced from 10.2 metre as stated in the original Bill of Quantities to 9.0 metres to mitigate the increase of costs on the above variations.