

Road Network Improvement Priority Road Project-2 - 2014

The audit of financial statements of the Road Network Improvement Priority Road Project-2 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 read in conjunction with Loan Facility Agreement No. 4500062212011110472 dated 31 March 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Facility Agreement of the Project, then Ministry of Highways, Ports and Shipping, presently the Ministry of Higher Education and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is the improvement and rehabilitation of 591.48 kilometres of priority roads as contemplated under the construction contracts. As per the Loan Facility Agreement, the estimated total cost of the Project was 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 provided by the 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 Project had been extended up to 31 December 2014.

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 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.

1.4 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 judgment, 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 the 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 Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identification of the purchases made out of the Loan etc.
- d)** Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Facility 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 Public Sector 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 financial covenants laid down in the Loan Facility 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 Public Sector Accounting Standards.
- (b) the funds provided had been utilized for the purposes 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 Facility Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

Balances of Work- in- progress amounting to Rs.69,881 million and payables to the contractors amounting to Rs.11,458 million shown in the financial statements for the year ended 31 December 2014 had been understated by Rs. 245.29 million due to erroneous accounting treatment.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, 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		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
China Development Bank	500	55,250	19,368.6	147.00	19,267.7	375.94	49,328
GOSL	56	6,188	1,819.3	13.88	1,819.3	46.87	6,150
	556	61,438	21,187.9	160.88	21,087.0	422.81	55,478

According to the above information, proceeds of Loan of US\$ 375.94 million had only been utilized up to 31 December 2014, out of US\$ 500 allocated for the Project. This indicated that only 75 per cent of the allocation under the Loan had only been utilized at the end of the year under review.

3.2 Physical Progress

The activities of the Project had included to rehabilitate 18 Sections of 476.48 kilometres of national roads, 115 kilometers of provincial roads in Nuwaraeliya and Hambantota districts, construction of 02 flyovers and reconstruction of 18 bridges. According to the information made available, all the road works except 03 Sections of national roads in Badulla, Kalutara and Kandy districts and provincial roads in Nuwaraeliya district, construction of flyovers and reconstructions of bridges had been completed by the Project as at 31 December 2013. The Project Director had informed that the rehabilitation works of 03 Sections of the national road and provincial roads had been substantially completed as at 30 June 2014.

3.3 Contract Administration

The following observations are made.

- (a) It was observed that scope of Horawala-Pelawatta-Pitigala Road had been changed from asphalt surfacing to concrete surfacing at 06 locations. However, the Project had not explained the reasons for such changes. Further, it was observed that the variation order thereon also had not been approved even as at 31 December 2014. It was revealed at the site visits made by the auditors that motorable condition of the road was not satisfactory due to defects in concrete layer. Further, cracks at 0+155 kilometre of the Road and holes from 4 +235 kilometre to 4+240 kilometre

of the Road were appeared. In addition, according to the technical specification No.506.5(j) of the Contract Agreement, the density of all samples from the compacted surface course shall not be less than 98 per cent of the marshall density but compaction of the asphalt concrete in 18 locations were not reached to the above limits.

- (b) The contract for the rehabilitation of Thiruwanaletiya-Agalawatta Road scheduled to be completed before 11 December 2013 and extended up to 15 July 2015. In accordance with Clause No.8.3 of the Conditions of the Contract, the contractor is required to submit a revised programme to catch up the delays and to complete the works on time. However, the contractor had not submitted such a revised programme. The site visit made thereon had revealed that the contractor had not complied with the environmental protection plan to minimize the inconveniences affected to the surrounding landowners and Road users and there were many complaints against the contractor.

- (c) It was observed that rates applied for the Bill of Quantities of Horawala-Pelawatta-Pitigala Road rehabilitated under this Projects was significantly varied with the rates applied for Bill of Quantities of Thiniyawala-Kankotiyawatta-Morawaka Road of which rehabilitated under Priority Road Project I eventhough such roads were located in the same area. As a result, the cost per kilometers for rehabilitation of such roads were remained at Rs. 102 million and Rs. 73.5 million respectively. The reasons for application of different rates were not explained to audit.

3.4 Human Resource Management

It was observed that 04 Consultants had been recruited contrary to the provisions of the Management Services Circular No. 33 of 05 April 2007 and remuneration and transport allowances aggregating Rs. 2.82 million had been paid them during the year under review. The performance reports had not been furnished to audit as enable to evaluate their contribution to the Project.