

### **National Highways Sector Project (Additional Financing) - 2013**

The audit of the financial statements of the National Highways Sector Project (Additional Financing ) 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 2.09 of Article ii of the Project Agreement No. 2767 SRI dated 14 December 2011 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 Project Agreement, the Ministry of Highways Ports and Shipping (MOHP&S) and the Road Development Authority (RDA) are the Executing and Implementing Agencies respectively of the Project. The objective of the Project is to improve the national transport efficiency by upgrading rehabilitation and realignment of about 62km of national highways. According to the Loan Agreement, the estimated total cost of the Project is US \$ 105.60 million equivalent to Rs. 13,728 million and out of that US\$ 85 million equivalent to Rs.11,050 million was agreed to be financed by the Asian Development Bank. This Project is implemented to provide additional finance for simultaneous Project called National Highways Sector Project implemented under the Project Agreement No. 2767 SRI dated 14 December 2006 entered into between the GOSL and ADB which was completed on 31 December 2013. Even though these two projects are administered by the same Project Monitoring Unit (PMU), the financial statements for the year ended 31 December 2013 for respective Projects are submitted separately. The activities of this Project are expected to be completed on 31 December 2015.

#### **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 basis 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 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 purchases made out of the Loans, etc,
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,

- (d) Whether the funds, materials and equipment supplied under the Loan 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 balance ,withdrawals from and replenishments to the Imprest 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 Agreement,
- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) Whether financial covenants laid down in the Loan Agreement 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 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 Agreement,
- (d) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) the financial covenants laid down in the Loan Agreement 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. 4,264 million and the cumulative expenditure as at 31 December 2013 amounted to Rs. 6,043 million. The following statement shows a summary of the expenditure for the year under review, the expenditure for the preceding year and the cumulative expenditure as at 31 December 2013.

<u>Description</u>	<u>Expenditure as at 31 December</u>		Cumulative Expenditure as at 31 December 2013
	<u>2013</u>	<u>2012</u>	
	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>
Fixed Assets-at cost	828,716	-	828,716
Construction Work In Progress	1,836,241,596	440,079,828	2,276,321,424
Consultancy Cost	204,667,909	262,146,880	466,814,789
Land Acquisition and Resettlement Cost	1,145,172,006	1,165,137,791	2,310,309,798
PMU Expenditure	76,119,866	4,230,277	80,350,143
Interest on Loan	20,038,696	17,400,545	37,439,241
Net Current Assets	980,583,810	(109,652,275)	870,931,535
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Total	4,263,652,599	1,779,343,046	6,042,995,646
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**4.2. Imprest Fund Account**

According to the financial statements and information made available, the operations of the Imprest Fund Account during the year under review and balance as at 31 December 2013 are summarized below.

	US\$	Rs	Rs
Balance as at 01 January 2013	1,394,244		177,293,152
Add: Replenishments	1,550,681	203,485,350	
Foreign Exchange Gain		1,189,928	
			204,675,278
	2,944,925		381,968,430
Less: Withdrawals	2,455,673		317,997,319
	489,252		63,971,111

**4.3 Loan Covenants.**

According to Schedule 03 Section 06,(b) of Loan Agreement , the ADB has agreed to establish an Imprest Account at the Central Bank of Sri Lanka. Further the ADB has agreed to apply Statement of Expenditure Procedure for reimbursement of eligible expenditure provided into the Imprest Account in accordance with the Loan Disbursement Handbook and detailed arrangement agreed upon between the borrower and ADB. According to the above arrangement individual payment to be reimbursed shall not exceed US \$ 100,000. However, the respective limit had been exceeded in 09 occasions during the year under review.

**5. Audit Observations**

**5.1 Accounting Deficiencies**

The following observations are made.

- (a) Provisions for the accrued expenditure relating to the works valued at Rs. 185,991,091 completed during the year under review had not been made in the financial statements.
- (b) Some information required to include in Cash flow statement had not been included.

**6. Financial and Operating Review**

**6.1 Utilization of Funds**

According to the information made available, certain significant statistics relating to the financing of the Project budgetary provision and the utilization of funds during year under review and funds utilized as at 31 December 2013 are shown below.

	<u>Amount agreed to be provided in the Loan Agreement.</u>		<u>Amount allocated in the Annual Estimates 2013</u>	<u>Amount utilized during the year under review</u>	<u>Funds utilized as at 31 December 2013</u>	
	<u>US\$</u>	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>	<u>US\$</u>	<u>Rs.</u>
	<u>millions</u>	<u>millions</u>	<u>millions</u>	<u>millions</u>	<u>millions</u>	<u>millions</u>
ADB	85.00	11,050	2,526	2,526	28.32	3,723*
GOSL	20.60	2,678	1,139	1,139	17.85	2,321*
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	105.6	13,728	3,665	3,665	46.17	6,044
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\* The cost incurred on land acquisition, surveys shifting of utilities under the previous ADB Loan No. 2767 had also been included under the cost of this Project.

**6.2 Contract Administration**

**6.2.1 Road Improvements**

According to the information received, the details of the improvement of roads expected to be completed under the funds allocated by the Project are given below.

<u>Road</u>	<u>Length</u> <u>Km</u>	<u>Amount</u> <u>allocated</u> <u>Rs millions</u>
A24 Matara – Godagama	3.40	671
B153 Hikkaduwa- Southern Highway	14.34	1,378
B157 Aluthgama- Southern Highway	11.07	1,892
B 207 Katukurnda- Nagoda	2.72	388
A004 Kirulapona- Godagama	13.3	1,400
B 084 Pamankada- Kesbewa	12.76	3,721
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<b>Total</b>	<b>57.59</b>	<b>9,450</b>
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6.2.2 Out of the above, test examinations had been carried out for Katukurnda- Nagoda Road improvement works and Pamankada - Kesbewa Road. The following observations are made in that connection.

- (a) Road improvement works of B 207 Katukurnda- Nagoda Road had been commenced on 25 May 2012 and expected to be completed before 17 August 2013. According to the progress reports furnished by the Consultant, physical progress of the improvements of the road remained at 89 per cent as at 31 December 2013. The following further observations are made in this connection.
- (i) According to the progress reports, the contractor had performed poorly at the initial stage of the road improvement works and several preliminary works such as grubbing, site clearing and excavation works due for completion before 30 June 2013 had been completed after long delays. Further, the work programs of several other works such as construction of retaining walls and application of asphalt regulating course had been revised due to above mentioned delays. However, such amended work programs due for completion before 31 March 2013 had also not been completed even by 31 December 2013. Delay in utility shifting, pipe laying and land acquisition had resulted in the extension of the date of completion up to 06 April 2015.

- (ii) The revised cost estimates shows a significant increase of the cost of contract due to soft ground treatment works, utility shifting and underestimation of items in the Bills Of Quantities. The revised cost forecast to increase cost of contract to from Rs.346 million to Rs.400 million had been prepared and submitted to RDA on 06 March 2014.
- (b) The improvement works of Kesbewa - Pamankada Road had been commenced on 28 March 2013 and is expected to be completed before 28 March 2015. According to the progress reports furnished by the Consultant, physical progress of the improvement of the road remained at 13.14 per cent as at 31 December 2013, as against the expected target of 14.88 per cent as at that date. The following further observations are made in this connection.
- (i) According to the Public Finance Circular No. 2/2012 of 07 August 2012 estimates for all procurements should be made by considering the all matters to ensure the accuracy of the total cost of the Procurement. However, rehabilitation works of the two sections of the road amounting to Rs.660.9 million and the cost of the bridge at Pamankada amounting to Rs.95 million had been withdrawn from the initial estimate and new bridge at Rattanapitiya had been included without ascertaining the cost of such bridge. It is observed that, this situation will lead to lot of dispute and unfavourable effects to the Project. Further, approval from the Cabinet Appointed Tender Board (CATB) had not been obtained for such scope variations.
- (ii) Even though the Engineers' estimate for lump sum payments on preliminaries and general items amounted to Rs.145.33 million, the contractor had quoted a sum of Rs.256 million for such works. However, rate analysis had not been carried out before approving the contractor's estimate.
- (iii) Even though the contract agreement had been signed on 01 October 2012, the possession of the site for the Phase 01 of the rehabilitation works had been handed over on 25 March 2013 after delay of 06 months. Further, the possession of site for Phase 02 (section from 1+150 km to 10+450km) of the road had also been handed over to the contractor on 20 May 2014,



after a delay of two months. According to the revised Bills Of Quantities prepared by the Engineer, cost of the rehabilitation works had been increased by Rs.30.36 million for preliminary and general items due to delays in commencement of the rehabilitation works.

- (iv) Even though the second installment of mobilization advance amounting to Rs.249.19 million had been released on 19 February 2013, the contractor had commenced the works only on 28 March 2013, after delay of 3 ½ months from the release of mobilization advance first installment. According to paragraph 14.2 (ii) of Special Contract Clauses, the contractor is required to mobilize before releasing the second installment of the mobilization payments.
- (v) According to Paragraph 14.6 of the Special Conditions of the Contract, minimum value of interim payment was limited to Rs.66.4 million. However, interim payments made on 07 occasions, out of 09 occasions made during the year under review had not reached up to the required minimum limit.
- (vi) According to the Condition of Contract, 80 per cent of advances on the material at site is allowed to pay after verifying the respective bills. However, such allowances amounting to Rs.49.90 million had been made without verifying document evidence.
- (vii) According to the Rule 106 of ICTAD SCA 5, interim payments should be made after making measurements of work done. However, interim payment amounting to Rs. 79.74 million had been released in November 2013 without verifying the works through physical measurements. Further, overpayments included therein amounting to Rs.18.64 million and had been recovered in December 2013.
- (viii) Even though a field laboratory had not been established by the contractor at the end of the year under review, laboratory equipment costing Rs. 7.82 million had been purchased. Further, an additional amount of Rs. 2.2

million had been included therein for maintenance of field laboratories and equipment. Further, the testing equipment purchased by the contractor at a cost of Rs. 7.82 million for laboratories maintained by the contractor had included 10 per cent margin for profit and overheads etc. amounting to Rs. 85 million. According to the Bills of Quantities, an allocation amounting to Rs. 5.27 million had been made to purchase laboratory equipment and maintenance of separate laboratories for the Consultant. However, these had not been established to ensure the quality of materials used for road works.

- (ix) Insurance cover for all risk should be obtained for entire Project period by the contractor. However the contractor had obtained separate insurance cover for various categories on an annual basis. Therefore the a sum of Rs. 10 million had been paid to the contractor as insurance on lump sum basis instead of verifying the cover obtained and premium paid by the contractor. Further the insurance cover for workmen's compensation should be obtained for all employees. However, instead of obtaining of insurance cover for average work force of 300 workers temporary cover or short periods had been obtained for the existing staff during the respective period such as 51,94,106 employees etc.

### **6.3 Matters in Contentious Nature**

The following observations are made.

- (a) A sum of Rs. 100,000 had been spent by the Project, for preparation of preliminary plan of Wethara alternative road which was not included in the scope of work under improvement at Pamankada – Kesbewa Road.
- (b) A sum of Rs. 4,860,000 had been spent as compensation to 27 encroachers, who occupied land near the Pillewa Temple along Horana- Colombo Road.
- (c) Fuel cost amounting to Rs. 191,897 had been incurred by the Project for a motor vehicle which was not used for activities of the Project.

- (d) Even though the payments under foreign funded project are exempted from Value Added Tax in term of Value Added Tax Act, No 14, of 2002, a sum of Rs.278 million had been paid by the Project as payment on road improvement works and consultancy services

#### **6.4 Land Acquisition**

It was observed that the compensation aggregating Rs. 2,310 million had been paid at the end of the year under review for land acquisitions and resettlement purposes of rehabilitation of five roads, out of total allocation amounting to Rs. 2,678 million made thereon. The following observations are made in this connection.

- (a) According to the information received, 2681 plots of land had been acquired for the improvement of Kesbawa – Pamankada Road and a sum of Rs.257.1 million had been paid up to 31 December 2013. It was observed that only 2270 plots of land had qualified for payment of compensation. Payments had been made for 284 plots of land only. However Rs. 2.1 million had been paid as interest on delay in payment of compensation for land acquisition.
- (b) According to the test check, 103 plots of land acquired for Piliyandala bypass at Pamankada- Kesbawa Road had been selected for the payment of compensation. However, compensation amounting to Rs. 89 million had been paid only for 91 plots of land. The interest paid thereon had not been identified separately.
- (c) The expenditure on compensation for land acquisition had not been separately identified as statutory payments, Land and Resettlement Committee (LARC) payments, advance payments and incentive payments, etc. Therefore expenditure could not be reconciled with documents rendered for audit by the Land Section of the Project.