

Provincial Road Project (Northern Province) – Part A.3 and B.3 (PRP) -2013.

The audit of financial statements of the Provincial Road Project (Northern Province)– Part A.3 and B.3 (PRP) 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 11 (B), 3 of Schedule 2 of the Financing Agreement No.4630 – LK dated 11 January 2010 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the International Development Association (IDA) and Section 2.01(b) of the Implementation Agreement dated 23 May 2010 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and IDA.

1.2 Implementation, Objective, Funding and Duration of the Project

According to the Financing Agreement and the Implementation Agreement, the Ministry of Local Government and Provincial Council is the Executing Agency and the Northern Provincial Council of Sri Lanka is the Implementing Agency of the Project. The Project is implemented through a Project Management Unit (PMU) established at the Northern Provincial Council. The objective of the Project is to improve access to Socio – Economic Centres in the Northern Province of Sri Lanka through the sustainable management of improved road infrastructure. According the above mentioned Agreement, the estimated total cost of the Project is SDR 66,100,000 and the full amount was agreed to be financed by the IDA. The Project commenced its activities on 31 March 2010 and is scheduled to be completed by 31March 2015.

1.3 Activities of the Project

According to the Agreement, the Activities under Parts A.3, B.3 and C of the Project are summarized below.

Part A.3: Rehabilitation of Provincial Roads

Upgrading, and rehabilitation of approximately 100 kilometers of provincial roads and other road infrastructure in selected areas of the Jaffna District of the Northern Province.

Part B.3: Maintenance Programme

Development and implementation of an effective maintenance strategy including carrying out of routine, preventative and emergency maintenance for the network of paved roads in the Northern Province.

Part C: Implementation Support and Capacity Building

Strengthening the capacity of the Provincial Road Development Department and the local construction industry in planning and budget management and Project implementation, through the provision of technical assistance (including supervision of works contracts under Part A of the Project) and training, the acquisition of office and laboratory equipment and vehicles, and the carrying out of selected studies.

1.4 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 Accountings 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 reasonable 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 a reasonable basis for my opinion. The examination also included such test of systems and controls, transaction assets and accounting records as deemed necessary to assess the following.

- a) Whether the systems and control were adequate from the point of view of internal controls so as to ensure a satisfactory control over Project management and the reliability of books, records, etc., relating to the operation 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 operation of the Project, the identification of purchases made out of the Loan, etc.
- c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Financial Agreement.
- d) Whether the funds, materials and equipments 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 balances, withdrawals from and the 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 financial covenants laid down in the Financing 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 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 opening and closing balances, withdrawals from the 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,
- (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 Financing Agreement, and,
- (e) The financial covenants laid down in the Financing Agreement had been complied with.

4. Financial Statements

4.1. Financial Performance

According to the financial statements furnished to audit, the project expenditure for the year under review amounted to Rs. 542,568,595 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 1,223,488,881. 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.

Item of Expenditure	Expenditure for the year ended 31 December		Cumulative Expenditure as at 31 December 2013
	<u>2013</u> Rs.	<u>2012</u> Rs.	Rs.
Civil Works	459,483,141	370,277,508	978,802,668
Plant and Equipment	-	1,982,186	6,645,200
Consultancy	70,776,039	61,546,564	196,861,795
Incremental and Operating Cost	12,309,415	13,024,459	41,179,218
	<u>542,568,595</u>	<u>446,830,717</u>	<u>1,223,488,881</u>

4.2. Imprest Fund Account

According to the financial statements and information made available, the operations of the Imprest Fund Account of the Project during the year ended 31 December 2013 and the balance available in that account as at that date are summarized below.

	<u>US\$</u>	<u>Rs.</u>
Balance as at 01 December 2013	3,396,722	431,929,896
Add: Replenishments	3,396,338	444,813,183
Foreign Exchange Gain	-	4,171,131

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	6,793,060	880,914,210
Less: Withdrawals	4,186,696	540,124,304
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Balance as at 31 December 2013	<u>2,606,364</u>	<u>340,789,906</u>

5. Audit Observations

5.1. Accounting Deficiencies

The following observations are made.

- a) The mobilization advances amounting to Rs 90,868,521 made to the contractors who defaulted the work had been subsequently recovered through guarantee bonds and refunded to the General Treasury. However, necessary accounting entries thereon had not been made and as a result, Project expenditure had been overstated by that amount.

- b) A performance bond of a defaulted contractor valued at Rs.62,987,352 had been encashed and credited to the Provincial Fund Account without being brought to account in the financial statement.

5.2. Lack of Evidence for Audit

Two payments relating to relocation of electrification and telecommunication poles amounting to Rs. 50.7 million payable to the Ceylon Electricity Board and Rs. 14.4 million payable to the Sri Lanka Telecom had been directly made to the contractors. However, the details of payments made, work estimates, work completion reports, work-in-progress etc. had not been furnished to audit.

6. Financial and Operating Review.

6.1. Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provisions for the year under review to the Project Implementation Unit, utilization of funds during the year under review and the cumulative expenditure as at 31 December 2013 are shown below.

Source	Amount agreed to be financed		Allocation made in the Annual Budget	Amount utilized during the year under review		Amount utilized as at 31 December 2013	
	US\$ Mn	Rs Mn	Rs Mn	US\$ Mn	Rs	US\$	Rs
IDA	20.00	2,285.00	755.00	3.40	540.12	8.88	1,125.40
GOSL			5.00		2.44		8.22
Total	20.00	2,285.00	760.00	3.40	542.56*	8.88	1,133.62*

* The amounts shown in the above schedule were not agreed with amounts shown in the paragraph 4.1 of this report due to accounting treatments made for accrued expenses

6.2. Physical Performance

6.2.1 Contract Administration

The following observations are made.

- (a) Although the concurrence of IDA had been received on 25 July 2012 to terminate the contracts on package Nos. 03 and 05, the contracts of two packages were terminated only on 23 November 2012 after the lapse of four months. The terminated contracts were re-awarded only on 02 November 2013 after a delay of 15 months.

- (b) Variance of the scope of work done under Rehabilitation Part of the Project had been regular feature, thus indicating that the BOQs for the rehabilitation works had been prepared without ground surveys. The works valued at Rs. 58.82 million under Package No. 01 and works valued at Rs 39.03 million under Package No 02 had not been approved by the IDA.
- (c) Payments aggregating to Rs.65 million for relocation of the poles of Ceylon Electricity Board and Sri Lanka Telecom had been made during the year 2013, under Package -02. However the progress of the relocation works had been slow.
- (d) According to the Clause D -43 of the Condition of Contract, the completed works should be taken over by the Project within 07 days after the completion of the works. However; the works completed on 26 October 2012 had not been taken over by the Project within seven days. Further, the works completed under Package 2 on 03 September 2013 had been taken over on 13 January 2014 after a delay of four months.
- (e) In terms of clause GCG55.1 of the Condition of the Contract the contractor should submit “as built drawings” within three months of the date of completion to the Project after obtaining approval from the Consultant. But the contractor had not submitted such drawings even up to the date of this report.

6.3 Uneconomic Transactions

A sum of Rs. 443,372 had been paid as legal expenses during the year under review to prepare legal documents with regard to termination of contracts and a sum of Rs. 444,370 paid for adjudicators even though two legal officers had been already appointed by the Provincial Council at monthly allowances of Rs. 70,000 and Rs. 50,000 respectively for legal service.

6.4 Matters of Contentious Nature

The following observations are made.

- a) A sum of Rs. 10,500,000 had been paid to the Chief Secretary, Secretary to the Ministry of Infrastructure and Deputy Chief Secretary (Finance) as coordinating allowance for the years 2011 to 2013. Based on the matters pointed out in the previous audit reports, the approval for the payments had been obtained from the Secretary to the Ministry of Local Government and Provincial Councils to pay the allowances with effect from 28 November 2013. However, no action had been taken to recover the payments made prior to the date of receipt of the approval of Secretary to the Ministry.

- b) Even though the monthly income of the officers who were paid monthly coordinating allowances had exceeded Rs. 50,000 the Pay As You Earn Tax had not been recovered in terms of provisions in the Inland Revenue Act, No. 10 of 2006.

7. Systems and Controls

Special attention is needed in respect of the following areas of control.

- (a) Accounting.
- (b) Maintenance of proper Accounting Records
- (c) Advances and Imprest
- (d) Contract Administration