

Road Sector Assistance Project - 2013.

The audit of financial statements of the Road Sector Assistance Project (RSAP) 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 4.01(b)(i) of Article IV of the Development Credit Agreement No.4138-CE dated 16 January 2006 entered into between the Democratic Socialist Republic of Sri Lanka(GOSL) and the International Development Association (IDA).

1.2 Implementation, Objectives, Funding and Duration of the Project

Development Credit Agreement of the Road Sector Assistant Project, then Ministry of Highways and Road Development (MOH & RD) presently, the Ministry of Highways, Ports and Shipping (MOHP&S) Executing Agency and the Road Development Authority (RDA) is the Implementing Agency of the Project. The objective of the Project is to lower transportation cost through sustainable delivery of an efficient national road system. Development Credit Agreement, the estimated cost of the Project is SDR 69,100,000 equivalent to US\$ 100 million and Rs. 10,125 million and the entire amounts was agreed to be financed by the International Development Association. Further, an additional allocation of SDR 59,600,000 equivalent to US\$ 98.1 million and Rs. 11,579 million had been provided under the first Supplementary Development Credit Agreement No.4429 CE dated 23 June 2008 entered into between the Democratic Socialist Republic of Sri Lanka and the IDA. Further, the Second Supplementary Development Credit Agreement No.4906 CE had been entered into between the Democratic Socialist Republic of Sri Lanka and IDA on 15 March 2011 and an additional allocation of SDR 63,600,000 equivalent to US\$ 100 million and Rs 11,081 million had been made thereon. Initially, the Project commenced its activities on 16 January 2006 and was scheduled to be completed by 31 March 2011. However, the Project period had been extended up to 30 September 2014 as per provisions made in the Second Supplementary Development Credit Agreement.

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 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 reasonable basics 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 (GOSL) 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 Loan etc.

- c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Development Credit Agreements.
- 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 Special (Dollar) Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances 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, and
- 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 Development Credit 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 opening and closing balance, withdrawals from and replenishments to the Special Dollar Account during the year ended 31 December 2013 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 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 Loan Agreement,
- (e) Satisfactory measures had been taken by the management to rectify the issues highlighted in 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 expenditure of the Project for the year under review amounted to Rs. 4,936,882,103 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 32,113,493,499. The following statement shows a summary of the expenditure for the year under review and the preceding year and the cumulative expenditure as at 31 December 2013.

Description	Expenditure during the year ended 31 December		Cumulative expenditure as at 31 December 2013
	2013	2012	
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	Rs.	Rs.	Rs.
Property, Plant and Equipment - Cost	64,217,352	37,382,303	282,932,946
Civil Works	-	-	22,545,175,549
Civil Work-in-Progress	468,184,471	2,935,852,461	3,476,245,967
Design Consultancy	-	-	122,604,638

Project and other Consultancy	22,327,897	18,616,519	127,557,404
Construction Supervision	667,713,673	17,215,520	684,929,194
Project Expenses	94,264,520	161,978,284	600,471,063
Training	7,432,859	17,478,447	74,558,387
Relocation of Utilities	186,319,135	7,084,035	501,676,989
Net Current Assets	3,426,422,196	332,379,261	3,697,341,362
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	4,936,882,103	3,527,986,831	32,113,493,499
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4.2 Special (Dollar) Accounts

According to the financial statements and information made available, three Special (Dollar) Accounts had been maintained at the CBSL during the year under review for all three Agreements. A summary of the operations and the balances of respective accounts as at 31 December 2013 are given below.

Loan No	4429CE		4906CE		4138CE	
	USD	SLRs	USD	SLRs	USD	SLRs
Balance as at 01						
01 January 2012	9,113,859	1,158,925,538	377,195	47,964,399	560,768	71,307,692
<u>Add</u>						
Replenishment	-	-	34,735,300	4,425,946,399	1,436,203	181,305,441
Foreing Exchange		6,579,837	-	120,202,275	-	5,302,768
Gain						
	9,113,859	1,165,505,375	35,112,495	4,594,113,073	1,996,971	257,915,901

Less

Withdrawals	7,930,387	1,010,762,966	14,464,036	1,894,265,046	1,682,903	216,850,615
Foreing Exchange Loss	-	-	-	-	-	-
Balance as at						
31-Dec-2013	1,183,471	154,742,409	20,648,460	2,699,848,026	314,068	41,065,286

5. Audit Observations

5.1 Accounting Deficiencies

Following observations are made.

- a) Although fixed asset procured at Rs. 224,228,425 had been transferred to the RDA since the year 2010, those had been depreciated continuously and shown in the financial statements without transferring the net value of the assets to the RDA.
- b) Assets to the value of Rs. 188,910,898 and Rs. 66,094,176 had been procured and handed over to the RDA and Road Maintenance Trust Fund (RM TF) respectively during the year under review by the Project. Instead of showing the value of transferred assets under the beneficiaries in the financial statements a sum of Rs. 31,365,750 had been accounted as depreciation under the work in Progress of the Project.
- c) Neither provision nor disclosure had been made in the financial statements for contingencies liability on the arbitration case of filed against the Project by the contractor of Ingiriya -Rathnapura Road.
- d) Provisions for the accrued expenditure relating to the works to the value at Rs. 3,303,631 completed during the year under review had not been made in the financial statements.
- e) Provisions had not been made for the balance payment of Rs. 6,987,238 for the supply of GI pipes to the Project during the year under review.
- f) The incentive payment of Rs. 327,530 and overhead expenditure of Rs. 1,076,276 in respect of the RDA staff attached to the PMU had been paid to the RDA by the Project at the request of the RDA. It was observed that the RDA was not entitled to recover such expenditure from the Project in terms of instructions given in sections 8.3.9 and 8.6 of the Public Enterprises Circular No. PED/12 dated 02 June, 2003.

6. Financial and Operating Review

6:1 Fund Utilization

According to the Financial Statements and information made available, certain significant statistics relating to the Financing of the Project and the utilization of funds up to the end of the year under review are shown below.

<u>Financing Plan</u>	<u>Amount allocated under</u>		<u>Funds utilized Up to</u>	
	<u>foreign components.</u>		<u>31 December 2013</u>	
	<u>US\$</u>	<u>Rs.</u>	<u>US\$</u>	<u>Rs.</u>
	<u>Mn</u>	<u>Mn</u>	<u>Mn</u>	<u>Mn</u>
IDA Development				
Loan Nos.				
4138CE	100.0	10,125	74.1	9,642
4429CE	98.1	11,579	82.9	10,775
4906CE	100.0	11,081	35.4	4,597
Exchange Difference			3.0	392
GOSL			51.6	6,707
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Total	298.1	32,785	247	32,114
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6.2 Contract Administration

Rehabilitation of Ambepussa – Kurunegala - Trincomalee Road (A 06)9.3Km from Km 190+000 Km to 199+300 Km (KT 04).from Kantale to Trincomalee town.

The following observations are made.

- Although a sum of Rs.6,350,000 had been provided in BOQ to fixed metre in guard fence Trincomalee sea area and lagoon area and roundabout, 1723 meters had been erected and a cost of Rs.25.8 million. At the field inspection it was revealed that out of 1723 meter 1453 meter equalent to 78 per cent had been corrected within defect liability period. But damages had not been recovered from retention money. Further it was observed that designs drawings and specification are not comprehensive enough for another work.
- Although a sum of Rs. 450,000 had been included for the plastering work. In the variation order No. 2 for the construction of retaining wall of Sinhala Maha Vidyalaya Rs.3.06 million had been paid to contractor without attended to plastering of retaining wall.
- Although a sum of Rs. 8,115,000 had been paid of fixing of Stall 541 Nos. of sign boards by IPC No. 16 at audit inspection revealed that only 480 Nos. sign boards had been fixed and value of non-fixed sign boards amounted to Rs. 915,000.

6.3 Civil work in progress

The rehabilitation and improvement works of 5.286 Km from Maliban Junction to Kurusa Junction and 11.76Km from Panadura Bridge to Kurusa Junction of Colombo - Galle – Hambantota – Wellawaya Road had been carried under the supplementary loan agreement. The following observations are made in this regard.

- a) A separate detailed mobilization schedules for Lot 01 and Lot 02 should be Provided as a satisfactory evidence to ensure that the required machinery, equipment and personal are available to commence the work according to Clauses 2 and 6 of standard bidding document of ICTAD, clause 14.2 of particular condition and clause 2 and 6 of the contract condition. However it was observed that contractor had submitted only one schedule for both work sites of lot 01 and Lot 02 and it was paid an amount of Rs. 724,515,375 as mobilization advance for both sites contrary to the condition mentioned above.
- b) Available resources such as vehicles, machinery, equipment, labor etc were deployed for the contract under Lot No 01 since the contractor supplied required resource only for one site instead of two. However, as per the contract agreements contract under Lot No 01 and No 02 should be completed simultaneously providing required resource, separately for both sites and as a result of not providing required resource the progress of contracts under Lot No 02 was 7.8 per cent as against the progress of 28 per cent during the year under review.
- c) Acceptable control measure had not been applied on materials of road constructions of work as there had not been included any acceptable specific measures in the quality assurance plan as per paragraph 2,3,4,5 and 6 of section 7 in the plan to evaluate whether materials supplied to the site were in good quality and appropriate to the work. Further material purchased for the work site Lot No 01 and Lot No 02 had not been stored separately as per instruction given in section 13 of the above plan.
- d) According to the Section 16 of quality assurance plan the contractor should carry out daily sample testing of materials and failures should be recorded in the non – conformance report. Although the contractor had followed the daily sample testing of materials system non – conformance reporting system was not followed. As a result there were no documentary evidences to prove that whether the contractor had rectified the failures observed in testing. The supervision consultant of the Project had deployed 02 technical officers and a sum of Rs. 1,699,296 had been paid since the contractor had not applied the quality assurance system.

6.4 Consultancy Payments

The Project Consultancy Unit (PCU) had located at Trincomalee consist of 17 core staff and 25 supporting staff. Although those who are entitled to Project allowance of 50 percent are not entitled for overtime payments from the Project, a sum of Rs. 909,159 had been paid to as overtime to the officers those who received 50 per cent Project allowance during the year under review.

6.5 **Project Management Unit**

The project had recruited 12 core staff and 20 numbers of supporting staff to the PMU with the approval of the Department of Management Services and the following observation are made in this regard.

- a. The staff of the PMU had comprised with the officers selected from the RDA who were released on temporary basis by calling applications internally. However, according to paragraph 2.2.7 of the Management Server Circular No. 33 dated 05 April 2007 staff of the staff of the PMU of foreign funded projects shown be recruit through public notices to enable the recruitment of most competent person for the particular period.
- b. According to paragraph 4.1.1 of the above Circular, officers released on full time basis from the Government Agencies on no-pay leave and attached to a Project under contract basis are entitled for an additional allowance of 50 Percent of the salary of the permanent post. However, allowances aggregating Rs. 4.83 million had been paid to 34 officers of the RDA who released temporally to the PMU and PCU.
- c. As a practice, a provisional amount of gratuity of the staff of the RDA for the period of service at the PMU is remitted to the RDA by the Project. It was observed that the calculation of gratuity had been based on the entire period of service of the staff members including the service at the RDA instead of the period of service at the PMU. Therefore, an additional sum of Rs. 4.7 million had been remitted to the RDA up to 31 December 2013 for 22 officers of the RDA.
- d. Different personals had been recruited for key posts of the Project such as Project Directors, Deputy Directors, Engineers, Accountants, Administrative officers and Local Consultants from time to time during the previous 08 years. It was observed in audit the RDA as the implementing Agency, as a practice attached RDA officers to the Project in order to give Project experience and financial benefits. Hence the aspect of smooth functioning, timely implementation and closely monitoring of the Project had been given a less priority.
- e. Although cadre of the Project had been approved by the Department of Management Service in the General Treasury, two computer operators had been recruited in excess and paid Rs. 984,000 without obtaining the relevant approval.

6.6 **Matters in Contentions Nature**

Although the physical verification for the assets of the PMU for the year under review had been carried, fixed assets handed over to RDA, Ministry of Highway Ports & Shipping, Provincial councils, and RMTF had not been verified by the Project.

6.7 **Utilization of vehicles**

The Project had been entered into an agreement with a service supplier for the dry lease of 06 motor vehicles and a sum of Rs. 3,799,600 had been paid as hiring charges during year under review. It was observed that the Project had not utilized such motor vehicles to cover the minimum number of Kilometers allowed to be run per month. It was observed that the project had underutilized 37,934 kilo metres out of the minimum number allowed and hire changes paid amounted to Rs. 814,317. Further a sum of Rs. 394,002 had been paid to additional vehicles hired from outside during the year under review.

6.8 **Non – Compliance with Laws, Rules and Regulations**

The reimbursement register for the loan had not been maintained by the Project as per mentioned in the format sub Clause 5.6.14 of appendix vii of the Circular No 30/94 dated 20 April 1994 issued by the Department of State Accounts.

7. **Systems and Controls**

Deficiencies in the Systems and controls observed during the course of audit will be brought to the notice of the PMU in the management report. Special attention is needed in respect of the following areas of control.

- i. Management of PCU
- ii. Assets Management
- iii. Contract administration
- iv. Inventory Controls