

## **Eastern Province Rural Road Development Project -- 2013**

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The audit of the financial statements of the Eastern Province Rural Road Development Project 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 4.7 (a) of Article III of the Loan Agreement No. SL-P97 dated 26 March 2010 entered into between the Government of the Democratic Socialist Republic of Sri Lanka (GOSL) and Japan International Cooperation Agency (JICA).

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

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According to the Loan Agreement of the Eastern Province Rural Road Development Project, the Eastern Provincial Council is the Implementing Agency and the Ministry of Finance and Planning is the Executing Agency of the Project. The objective of the Project is to improve the livelihood of the people in Eastern Province by improving access to economic activities, market facilities and productive centers as well as by improving access to social services through rehabilitation of rural roads and thus to contribute to local economic development and mitigating regional inequality. According to the Loan Agreement, the estimated total cost of the Project is Japanese Yen.4,664 million equivalent to Rs.5,834 million and out of that, Japanese Yen.3,965 million equivalent to Rs.4,944 million was agreed to be finance by Japan International Co-operation Agency. The Project commenced its activities on 26 March 2010 and is scheduled to be completed by January 2014.

### **1.3 Responsibility of the Management for the Financial Statements**

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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**

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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 transaction. 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, 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 asset and liabilities arising from the operations of the Project, the identification of purchases made out of the Loan, etc.
- (c) Whether the 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 balances, withdrawals from and the replenishments to the Special Yen 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 as at that date.

- (h) Whether the 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.

### **3. Opinion**

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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 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 and replenishments to the Special Yen 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 Statement 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 my previous year audit report and,
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

4. Financial Statements

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4.1 Financial Performance

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According to the financial statements and information made available for audit, the expenditure of the Project for the year ended 31 December 2013 amounted to Rs. 2,036,594,207 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 5,634,640,807. The expenditure for the year under review, expenditure for the preceding year and the cumulative expenditure as at 31 December 2013 are summarized below.

Components	Expenditure for the year 2013	Expenditure for the year 2012	Cumulative Expenditure as at 31 December 2013
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	Rs.	Rs.	Rs.
Civil Works	1,825,586,628	1,994,709,433	4,916,461,578
Equipment	-	-	8,834,466
Consultancy Services	12,962,646	22,947,386	64,850,135
Administration Cost	44,586,297	52,542,712	155,979,859
Tax	142,640,497	207,768,153	448,666,937
Commitment Charges	929,823	3,824,825	10,598,972
Interest Charges	9,888,316	16,290,016	29,248,860
Total	<u>2,036,594,207</u>	<u>2,298,082,525</u>	<u>5,634,640,807</u>

4.2 Special Yen Account

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According to the financial statements and information made available, the operations of the Special Yen Account during the year under review and the balance available in that account as at 31 December 2013 are shown below.

	2013	
	JPY	Rs.
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Balance as at 01 January 2013	391,779,111	579,793,906
Add :		
Replenishments	1,409,610,769	1,836,893,243

	1,801,389,880	2,416,687,149
Less :		
Withdrawals	1,371,741,739	1,788,381,889
Foreign Exchange Loss	-	92,952,641
Balance as at 31 December 2013	429,648,141	535,298,619

## 5. Audit Observations

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### 5.1 Accounting Deficiencies

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Retention money amounting to Rs. 135,427,263 deducted from the interim payments made to the contractors engaged in 39 road rehabilitation works had not been recognized as liabilities of the Project. Therefore, the value of Civil work- in – progress and the retention money payable as at 31 December 2013 had been understated by that amount.

### 5.2 Non-compliance with Laws, Rules and Regulations

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Boards of Survey which should have been carried out at the end of each year in terms of Financial Regulation No 756 had not been carried out. Therefore, the physical existence of the fixed assets valued at Rs. 7,001,512 could not be satisfactorily verified in audit.

## 6. Financial and Physical Performance

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### 6.1 Utilization of Funds

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

Source	Amount agreed to be financed		Allocation made in the Annual Budget - 2013	Amount utilized during the year under review	Amount utilized as at 31 December 2013	
	Yen.Mn	Rs. Mn	Rs. Mn	Rs. Mn	Yen.Mn	Rs. Mn
JICA	3,965	4,944	1,859	1,849	3,508	5,030
GOSL	699	890	229	187	476	604
	<u>4,664</u>	<u>5,834</u>	<u>2,088</u>	<u>2,036</u>	<u>3,984</u>	<u>5,634</u>

The following observations are made.

- (a) According to the Loan Agreement, the JICA had allocated a sum of JPY.3,965 million equivalent to Rs.4,944 million for project activities. However, sums aggregating JPY. 3,508 million representing 89 per cent of the total allocation had been utilized up to 31 December 2013.
- (b) Out of a sum of Rs.890 million allocated by the GOSL for administrative expenses and other local taxes, sums aggregating Rs.604 million representing 68 per cent of total allocation had been spent up to 31 December 2013.

## 6.2 Physical Performance

### 6.2.1 Contract Administration

#### (a) Road Improvement work in Trincomalee District

A contract valued at Rs. 16,633,991 had been awarded on 12 February 2011 relating to concrete paving of 1.9 kilometers of first lane of Ethabendiwewa middle road, Ethabendiwewa road and first lane of Rotawewa road at Morawewa Divisional Secretariat Division. The following matters were observed in this connection.

##### (i) Ethabendiwewa Middle Road

- Bitumin had been applied on the surface of the concreted road at locations from 0 + 000 km to 0 + 100 km and 0 + 335 km to 0 + 700 km, in order to rectify the defects on dislodgment of aggregate due to poor quality of the concrete mixture.

- The quality test on compaction, and mixing and strength of the material used had not been carried out. According to the report of the National Building Research Organization, the concreting of the length of 210 meters at the location from 0+100km to 0+310km was not satisfactory due to poor mixing and quality of the material used. Therefore, defects had been rectified by overlaying of 100 mm thickness concrete. However, the cracks were found at 09 locations on the surface of the overlaid concrete layer. It was further observed that expansion joint had not been properly set while overlaying concrete layer.

**(ii) First Lane of Ethabandiwewa and Rotawewa Roads**  
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- The cover aggregate had not been made on the surface of the respective concrete roads and action had not been taken to rectify the defects before releasing the retention money to the contractor.
- According to Section 5.4.4 of the Procurement Guidelines – 2006, the advance payment should have been recovered before making 90 per cent of the payments to the contractor. However, advances amounting to Rs. 1,266,399 representing 38 per cent of the advance payment had only been recovered from the contractor while making payment for final bill.

**(b) Road Improvement Works in Batticaloa District**  
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A contract relating to the ten roads of total length of 4.065 kilometers in the Manmunai North Divisional Secretariat Division in the Batticaloa District with paving concrete at a cost of Rs 91,470,421 had been awarded on 22 May 2012. The following matters were observed in this connection.

- (i) Out of five bidders, a bidder who had quoted the lowest price of Rs. 54,998,282 had been selected to award the contract. It was observed that the rates for works quoted by the bidder had been altered twice. As a result, the bid price had been increased up to Rs. 91,470,422 representing 66 per cent over the original bid. Further, the Technical Evaluation Committee had also recommended the bid, without making reference to the alterations made.

(c) **Transaction with Contentious Nature**  
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The following matters were observed in connection with the submission of forged documents for Advance Guarantee Bond.

- (i) The Project had made a request to the respective commercial Bank to encash Guarantee Bond submitted by the contractor who was engaged on contracts No. PRRDP/EP/BT/P2/09 and No. PRRDP/EP/BT/P2/12 to recover the advances aggregating Rs. 4,950,000 granted thereon, due to failure of the contractor to complete the road rehabilitation works. However, the Bank had informed that such bonds had not been issued by the Bank. Therefore, it was proved that the contractor had submitted a forged document. The Project had not taken action to refer the Bond to the Bank before acceptance it and to take action against the contractor for submitting fraudulent Bond or against the officer who accepted the Bond without verifying from the Bank.
- (ii) In addition to above, the Project had accepted a performance bond valued at Rs. 1,539,600 on contract No. PRRDP/EP/BT/P2/12 from a private commercial Bank in Batticaloa and subsequently requested to encash the performance bond as the contractor had failed to complete the construction work as agreed. However, the Bank had refused to encash the bond stating that the signature placed in that bond was forged. The Project had not taken any action against the contractor or the officer who accepted the Bond without verifying its validity from the Bank.
- (iii) It was further observed that the period of other nine contracts valued at Rs. 349,930,558 had been extended during the year under review  
  
was found that bonds submitted at previous occasions were fraudulent and refused the extension of such performance bonds. However, the Project Director had accepted the fresh bonds obtained by respective contractors from an Insurance Company in the private sector without taking any action against the contractors responsible officer who had accepted the bonds without verifying their validity from the Banks.
- (iv) According to Section 7.8 of the Procurement Guidelines, the Bid should be rejected and not taken for further consideration, if the bidder had not signed in the Form of Bid. However, the Project had awarded the contracts even though the bidder had not placed his signature on bid documents related to the contracts No. PRRDP/EP/BT/P3/06 and No. PRRDP/EP/BT/P3/8B valued at Rs. 189,534,879.



