

Northern Road Connectivity Project Additional Financing – Provincial Component - 2014

The audit of financial statements of the Northern Road Connectivity Project Additional Financing – Provincial Component 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 Section 4.04 of Article (iv) of the Loan Agreement No. 2890-SRI(SF) dated 19 November 2012 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Northern Road Connectivity Project – Additional Financing, the Provincial Road Development Department of Northern Provincial Council and the Provincial Road Development Authority of North Central Provincial Council are the Implementing Agencies and the Ministry of Provincial Councils and Regional Development is the Executing Agency of the Project. The objective of the Project is to improve the road connectivity within the Northern Province and between the Northern region and the Southern region of Sri Lanka. The Project shall comprise:

Part B. Rehabilitation and Replacement

Rehabilitation of about 50 kilometres of provincial roads and rehabilitation and/or replacement of selected bridges in the Northern Province.

Part C. Rehabilitation and Replacement

Rehabilitation of about 70 kilometres of provincial roads and rehabilitation and/or replacement of selected bridges in the North Central Province.

As per the Project Administration Manual, the estimated total cost of the Project is US\$ 33.67 million equivalent to Rs.4,377 million and out of that US\$ 28.9 million equivalent to Rs.3,757 million was agreed to be financed by the Asian Development Bank. A sum of US\$ 4.77 million will be provided by the Government of Sri Lanka for the taxes and duties of the Project. The Project commenced its activities on 31 May 2013 and scheduled to be completed by 30 June 2018.

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 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 Scope of Audit and Basis of Opinion

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 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 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 the purchases made out of the Loan etc.
- (d) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipment 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 Generally Accepted Accounting Principles
- (h) Whether 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.

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 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 Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purposes for which they were provided.
- (c) the Statements of Expenditure (SOE) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement.
- (d) the 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.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) The retention money aggregating Rs.90,142,929 related to the contract payment made on rehabilitation of 07 roads under 05 packages implemented by the Project had not been disclosed in the financial statements. As a result , the value of civil works done had been understated by that amount.

- (b) The cost of a vehicle amounting to Rs.17 million procured by the Project through a contractor during the year under review and maintenance cost of 02 vehicles aggregating Rs.2.14 million had been shown as the cost of civil works carried out by the Project.

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 in the Loan Agreement		Budgetary Provision for the year 2014		Utilization of Funds			
	US\$ million	Rs. million	US\$ million	Rs. million	during the year under review		up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	28.90	3,757.00	16.43	2,136.9	11.86	1,542.06	12.90	1,677.25
GOSL	4.77	620.10	1.41	183.5	1.09	141.58	1.15	149.54
	<u>33.67</u>	<u>4,377.10</u>	<u>17.84</u>	<u>2,320.4</u>	<u>12.95</u>	<u>1,683.64</u>	<u>14.05</u>	<u>1,826.79</u>

3.2 **Physical Progress**

According to the Implementation Plan of the Project, 07 provincial roads in Anuradhapura District with the length of 75.65 kilometres, 05 provincial roads in Killinochchi District with the length of 27.21 kilometres and 02 provincial roads in Mulathivu District with the length of 24.49 kilometres were expected to be rehabilitated during the period of the Project. However, physical progress of 90 per cent had been reported as at 31 December 2014 on rehabilitation of all the provincial roads in Anuradhapura District. Further, 45 per cent of physical progress had been report on rehabilitation of 03 provincial roads in Kilinochchi and Mulathivu Districts as at 31 December 2014. The following observations are made on physical progress of the rehabilitation works of such roads.

- (a) The contract for rehabilitation of 03 provincial roads with the length of 14.76 kilometres in Killinochchi District had been awarded at the end of the year under review after 1 ½ years from the commencement of the activities of the Project. Further, action had not been taken by the Project to select a suitable contractor to rehabilitate Vattapalai-Kappaipilvu – Puthukudiriyruppu Road in Mulathivu District.
- (b) The physical inspection made by the audit officers had revealed that the surface and road shoulders at several locations of Kirigollewa- Heeralugama

Road in Anuradhapura District had been washed off as a result of failures of earth fillings and compaction etc.

3.3 Contract Administration

It was observed that the bank charges amounting to Rs. 19,625,000 had been paid at higher rates on performance and advance bonds valued at Rs.269,462,941 and it categorized as a lump sum allowances instead of provisional sum category. As a result, the Project had incurred an additional cost of Rs. 13,589,029 on banking charges on performance and advance bonds at the rates ranging from 5 per cent to 10 percent.