

## **Provincial Road Project – Uva Province - 2014**

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The audit of financial statements of the Provincial Road Project – Uva Province 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 4.09(b) of the Loan Agreement No. 4630 LK dated 11 January 2010 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association.

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

According to the Loan Agreement of the Provincial Road Project, Uva, Eastern and Northern Provincial Councils are the Implementing Agencies and then Ministry of Local Government and Provincial Councils presently, the Ministry of Provincial Councils and Regional Development is the Executing Agency of the Project. The objective of the Project is to improve access to socio-economic centers in the Uva, Eastern and Northern Provinces through the sustainable management of improved road infrastructure. According to the Project Appraisal Document, the estimated total cost of the Project – Uva Province is US\$ 67.2 million equivalent to Rs 7,592 million and out of that US\$ 60 million equivalent to Rs. 6,800 million was agreed to be financed by the International Development Association. The Project commenced its activities on 31 March 2010 and was scheduled to be completed by 31 March 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 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 Auditor's Responsibility**

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 identifications of the purchases made out of the Loan, etc.,
- (d) Whether the 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.

#### **1.5 Basis for Qualified Audit Opinion**

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

## **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, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, 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 (SOEs) 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**

A contingent liability arisen on an arbitration case filed by a contractor claiming Rs. 729 million had not been disclosed in the financial statements.

#### **2.2.2 Non - compliance with Laws, Rules and Regulations**

<b>Reference to the Laws Rules and Regulations</b>	<b>Non -compliance</b>
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(a) Inland Revenue Act No 10 of 2006	Pay As You Earn Taxes aggregating Rs 421,704 had not been recovered from 09 staff officers of the Project and remitted to Commissioner General of Inland Revenue.
(b) Paragraph 6(1)(a) and 12 of Public Contract Act, No. 3 of 1987	It was observed that 102 contracts, each valued over Rs.5 million had not been registered with the Registrar of Public Contract by contractors. Further, the members of the Procurement Committees and the Technical Evaluation Committees are liable for penalties for offering contracts for the contractors who do not register with the Registrar of Public

Contract by contractors.

- (c) Financial Regulations 756 and 757 Board of Survey of assets procured by the Project had not been conducted and the reports thereon had also not been submitted to the Auditor General.

### 3. Financial and Physical Performance

#### 3.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, 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		Funds utilized			
	US\$ million	Rs. million	during the year 2014		up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
IDA	60	6,800	9.24	1,206.00	51.72	6,413.31
GOSL	7.2	792	-	393.74		705.94
<b>Total</b>	<b>67.2</b>	<b>7,592</b>	<b>9.24</b>	<b>1,599.74</b>	<b>51.72</b>	<b>7,119.25</b>

#### 3.2 Contract Administration

The following observations are made

- (a) The contracts on civil works had been awarded in 2010 based on the works and cost estimation made at the time of preparation of feasibility study in 2004. As a result, the scope of works of the contracts and the costs thereon had changed significantly. Therefore, the overall estimated cost of the Project had increased by Rs 584 million at the end of the period of the Project.
- (b) According to the Guidelines on Procurements under IBRD Loans and IDA Credits of International Development Agency, the approval from the Lending Agency is required to be obtained for the price variations which exceed 15 per cent of the original cost estimate. However, the price variations valued at Rs 237.2 million made in 09 occasions on rehabilitation of the Kottegoda-Podumilla -Adiyarawatta- Maspanne- Yalagamuwa Road had not been approved by the International Development Agency.
- (c) The drainage systems for the rehabilitation of Galauda- Kandeketiya-Karametiya Road had not been implemented properly and as a result, the

rehabilitation works of the Road had shown progress of 87.5 per cent only as at 31 December 2014 even though it was scheduled to be completed by October 2012. Further, the rehabilitation works were not properly designed and as a result, a water supply scheme which provide drinking water for 138 families and paddy fields of 41 acres in extend had been adversely affected by storm water.

- (d) It was observed at the audit site visit that the edges at several locations of the Madetale- Pathanawatte- Tennapanguwa – Kiriwehera Road which was substantially completed by December 2014 had been washed off severely due to lack of proper drainage system and culverts, etc. Further, the maintenance works of the road carried out by the contractor was very poor due to lack of machinery, equipment and a proper maintenance schedule.

### **3.3 Matters of Contentious Nature**

The following observations are made.

- (a) The Project had obtained a Circuit Bungalow on lease basis through a contractor for the use of officers of the Project and rent amounting to Rs1,636,291 had been paid during the year under review. However, according to the records, the Circuit bungalow had been utilized only for 47 days of the year under review by the officers of the Project.
- (b) The road rehabilitation works under Galauda- Kandaketiya- Karamatiya Road had been offered to a contractor with foreign joint venture at a cost of Rs 767.33 million which was 32 per cent below the Engineering Estimate without calling further information from the bidder to confirm the feasibility of the road rehabilitation works. Further, the joint venture agreement had not been registered in Sri Lanka. The progress of the road rehabilitation works remained behind the scheduled targets despite the instruction of the Chief Secretary of the Uva Provincial Council to expedite the works. However, the liquidated damages amounting to Rs 42 million recovered had been repaid to the contractor subsequently without valid reasons. However, the contractor had filed an arbitration case and claimed a sum of Rs 729 million to resolve the disputes arisen with the Project. The alternative action had not been taken by the Project to furnish counter claims on delays in completion of the contract.
- (c) Additional charges on 6 per cent of bid value amounting Rs.18.63 million had been paid by the Project to 05 contractors on delays of evaluating and awarding of the bids during the bid validity periods. Such road rehabilitation works had been commenced after delays due to late implementation of the Procurement Plan, delays in appointing of Consultants and staff of the Project

and delays in signing of Supplementary Loan Agreements etc. Thus indicated that proceeds of the Project had not been utilized effectively for intended purposes.

- (d) It was observed that a sum of Rs 299.3 million representing 6.9 per cent of the total cost of the contracts had been included in the Bills of Quantities of 06 contracts to provide accommodation and transport facilities to the Consultants and the staff of the Project Monitoring Unit. According to the agreement entered into with the Consultant, 15 vehicles were required to be provided to the Consultant. However, 25 vehicles had been provided and additional amount of Rs 50.5 million had been spent thereon.

### **3.4 Issues on Financial Control**

The following observations are made

- (a) According to the Project Appraisal Report, it was expected to carry out internal audits of the transactions of the Project. However, the internal audit activities had not been carried by the Line Ministry and the reports thereon had not been submitted to the Project Implementation Agency and the Lending Agency.
- (b) Out of the allocation amounting to Rs.2,600 million made under the Project for the period from 2011 to 2014 for maintenance of provincial roads in Uva Province, only Rs.2,121 million had been utilized by the Project.

### **3.5 Achievement of the Objectives of the Project**

The following observations are made.

- (a) According to the feasibility studies of the Project, it was expected to reduce the travel time of the roads rehabilitated under the Project to enable to improve the level of community transportation system within the Uva Province. However, action had not been taken by the Uva Provincial Council to assess the travel time before and after the rehabilitation of roads and revise the time tables of community service buses under the purview of the Provincial Council.
- (b) Even though the need to establish a Road Assets Management System had been identified by the Feasibility Study of the Project, action had not been taken to establish such a system.