

China Development Bank Funded Priority Road Project 3 - (Phase I) - 2015

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase I) for the year ended 31 December 2015 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. This Project is implemented under the Loan Facility Agreement No. 4510201401100000245 dated 11 March 2014 and Loan Facility Agreement No.4510201401100000587 dated 24 November 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Facility Agreements of the Project, the Ministry of Higher Education and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve mobility of the National Highway Network of the country through the rehabilitation of sections of roads selected on a priority basis, thereby facilitating access to vital services and contributing to economic development activities. As per the Loan Facility Agreements, the estimated total cost of the Project amounted to US\$ 357.69 million equivalent to Rs. 46,184.54 million and out of that US\$ 300 million equivalent to Rs.38,736 million was agreed to be provided by the China Development Bank Corporation. The Project commenced its activities on 09 September 2014 and scheduled to be completed by 24 April 2017.

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 Sri Lanka Public Sector Accounting Standards 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 Loans, etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Facility Agreements.
- (e) Whether the funds, materials and equipment supplied under the Loans 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 Sri Lanka Public Sector Accounting Standards.
- (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 Facility Agreements 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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Public Sector Accounting Standards,

- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (d) the financial covenants laid down in the Loan Facility Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations were made.

- (a) It was observed that mobilization advances and creditors on civil construction works shown in the financial statements had been overstated by Rs. 826.27 million and Rs.320.96 million respectively due to erroneous accounting treatments.
- (b) Further, the value of civil works and retention money had been understated by Rs. 601.72 million and Rs. 96.41 million respectively due to an erroneous accounting treatment.

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 2015 are shown below.

Source	Amount agreed for financing in the Loan Facility Agreements		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		Rs. million	during the year under review		as at 31 December 2015
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
China Development Bank Corporation	300.00	38,736.00	17,274.00	127.40	17,273.30	149.36	20,132.05
GOSL	57.69	7,448.54	2,877.60	21.22	2,877.60	25.73	3,469.13
Total	<u>357.69</u>	<u>46,184.54</u>	<u>20,151.60</u>	<u>148.62</u>	<u>20,150.90</u>	<u>175.09</u>	<u>23,601.18</u>

3.2 Physical Progress

According to the Project Implementation Plan, 248.34 kilometres of the sections of 12 national roads are expected to be rehabilitated during the period of the Project. Out of that, rehabilitation works of 8.80 kilometres of Meegahajandura - Kumaragama Road had been completed as at 31 December 2015. However, rehabilitation works of the section from 1+65 kilometre to 3+90 kilometre of the Kandy-Jaffna Road and section of 0+00 kilometre to

20+00 kilometre of Mawanella-Hemmathagama-Gampola Road had shown slow progress due to delays in commencements of works and unsettled issues on land acquisitions. The physical progress of rehabilitation works of sections of 211.29 kilometres of 09 national roads had shown various stages ranging from 38 per cent to 89 per cent as at 31 December 2015.

3.3 Contract Administration

The following observations were made.

- (a) As a common feature, the scope of the rehabilitation works of the roads had been changed regularly. As a result, the risks on possible increases of the originally estimated costs and granting time extensions to complete the works cannot be ruled out in audit. Further, such issues could have been minimized if the proper ground surveys had been carried out at the initial stages. The instances observed are given below.
 - (i) The original scope of works of 9.81 kilometres of Dambokka - Katupitiya Road had been changed and the width of 12.5 metres of the road had been reduced by 1.70 metres. However, the boundary marks had not been located at the excess land acquired at a cost of Rs.1.62 million, thus indicated that the possible encroachment of lands by outsiders. According to the asphalt concrete test reports on 20 samples of the respective road, the air voids ratios and asphalt density of the 06 samples was not complied with the technical standards.
 - (ii) It was observed that the scope of the rehabilitation works of the section of 12+400 kilometre to 17+750 kilometre of Veyangoda - Ruwanwella Road had been changed after a year of commencement of works and included additional works of 18 culverts, construction of 05 retaining walls and reconstruction works of other 04 bridges.
 - (iii) The Bill of Quantities of the rehabilitation works of Marawila - Udubaddawa Road was prepared based only on typical drawings without conducting and detailed engineering investigations. As a result, 0.5 metres of the width of the hard shoulder had been curtailed. Further, it was observed that the expenses aggregating to Rs. 6.48 million spent for other purposes of the Road Development Authority and the Line Ministry had been treated as the rehabilitation works of this road.
- (b) The site visits made by the auditors in October 2015 at Kiriella-Nedurana-Eheliyagoda Road had revealed several deficiencies on contract administration as describe below.
 - (i) It was observed that the additional works valued at Rs. 35.34 million and Rs. 21.39 million for removal of electricity and water service lines respectively had been carried out as at 31 December 2015 for the rehabilitation of Kiriella-Nedurana- Eheliyagoda Road, eventhough such works could have been estimated at the design stage and included in the original estimates.

- (ii) According to the Section 113 of technical specifications of the contract agreement, the contractor should take action to pay compensation to the parties affected due to road rehabilitation works and reimbursed the cost incurred thereon from the Project with a margin of 30 per cent for overheads and profits. It was observed that the contractor had engaged only to distribute cheques issued by the Project instead of investing funds for the payment of compensation. However, a sum of Rs. 2.15 million had been recovered by the contractor during the year under review as a margin for overheads and profits, even though only Rs. 1.0 million had been allocated in the Bill of Quantities.
- (iii) The contractor had disposed debris in lower lands at the road sides from 09+875 kilometre to 09+990 kilometre of the road and a natural water streams were blocked, contrary to provisions made in the contract document for the purpose of environment protection. Further, it was observed at the site inspection that the devices including traffic signs, barricade boards and traffic cones etc. for safety and traffic control purposes were not used by the contractor at the time of continuing road rehabilitation works.
- (c) It was observed that a Material Engineer had not been deployed by the Consultant from 12 August 2015 to 31 December 2015 for the rehabilitation works of Hiniduma – Opatha - Pitabaddara Road. Therefore, agreed measures for quality assurance purpose had not been adopted by the Consultant.
- (d) According to the records maintained by the Consultant, the rehabilitation works of Rathnapura-Wewelwaththa Road from 0+00 kilometre to 27+500 kilometre had not been carried out as per technical standards due to poor curing treatments and allowing road for vehicle movements before hardening of surfaces. Even though the contractor had been instructed to adhere with technical standards and take immediate action to overcome the above short comings and improve traffic management and safety arrangements in several times, no action had been taken thereon. It was observed that the Project had not been carried out a ground survey of the road at the design stage and as a result, the scope of works had been curtailed by 03 kilometres of the road.
- (e) The rehabilitation works of Kandy - Jaffna road had been commenced with delays due to disputes in land acquisition. Further, the mobilization advances for the rehabilitation works of the respective road from 1.65 kilometre to 3.90 kilometre had been overpaid by Rs. 252.82 million, as the allocations for provisional sums and the contingencies was also included in estimated cost of the contract, contrary to the paragraph 5.4.4(i) of the Government Procurement Guideline.
- (f) According to the Section 1.2.1 of the Consulting Services Manual of National Procurement Agency issued in November 2007, competitive bidding procedure should be adopted for selection of Consultants for civil works. However, 02 Consultants selected for other Project called Priority Road Project -2 had also been employed as the Consultants of this Project without being applied the process of competitive bidding. Further, the payments for the Consultants had been treated as variations of the original agreement entered with the above

mentioned Project and as a result, the consultancy fees of this Project had been understated by Rs.95.58 million.

3.4 Fruitless Transaction

A sum of Rs.24.68 million had to be paid to the contractor involved in rehabilitation and improvement of Hiniduma - Opatha - Pitabaddara Road due to delays in settling of claims made by the contractor.

3.5 Human Resource Management

It was observed that the fruitful action had not been taken to fill the vacancies of the posts of 03 Deputy Project Directors and a Senior Engineer of the Project Monitoring Unit even after lapse of 03 years from the commencement of the activities of the Project. Further, only 03 Material Engineers were in service as at 31 December 2015, out of 06 posts of Material Engineers were approved for the Project. It was observed that the vacancies in the key posts of the Project remained continuously had badly affected to the smooth operations of the Project. However, other 02 Consultants had been recruited by the Project without an approval of Department of Management Service and allowances aggregating Rs.1.09 million had been paid during the year under review.