

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

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase II) for the first accounting 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. 4510201401100000587 dated 24 November 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank (CDB) Corporation.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Facility Agreement 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 initial objective of the Project was to reconstruct and rehabilitate 105 kilometres of 10 national and provincial roads in the Southern Province which provide crucial accessibility and social and economic benefits to the people who living in the area. However, the scope of the works of the Project had been rescheduled subsequently to reconstruct and rehabilitate 80.60 kilometres of 09 national roads in Kandy and Kegalle districts and 48.25 kilometres of other 11 rural roads in Kandy district. As per the Loan Facility Agreement, the estimated total cost of the Project amounted to US\$ 117.66 million equivalent to Rs. 15,594.14 million and out of that US\$ 100 million equivalent to Rs. 13,253 million was agreed to be provided by the China Development Bank Corporation.

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 judgement, including the assessment of the risk of material misstatements 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 Facility 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 Sri Lanka Public Sector Accounting Standards, and
- (h) Whether the financial covenants laid down in the Loan Facility 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 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, and
- (c) the financial covenants laid down in the Loan Facility Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Delays in submission of the Financial Statements

The financial statements of the Project for the year under review which required to be submitted for audit before 31 March 2016, according to the Circular No. MOFP/ERD/2007/02 of 07 August 2007 of the Ministry of Finance and Planning had been submitted for audit only on 02 November 2016.

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 first year under review are shown below.

Source	Amount agreed for financing in the Loan Facility Agreement		Allocation made in the Budget Estimate for the year under review	Fund utilized as at 31 December 2015	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million
CDB Corporation	100.00	13,253.00	-	-	-
GOSL	17.66	2,341.14	25.50	-	22.81
Total	<u>117.66</u>	<u>15,594.14</u>	<u>25.50</u>	=	<u>22.81</u>

3.2 Physical Progress

The following observations are made.

- (a) According to the information received, a Memorandum of Understanding had been signed with the China Development Bank Corporation on 28 May 2013 to rehabilitate 105 kilometers of 10 national and provincial roads in the Southern Province. Therefore, rehabilitation works of 12.87 kilometres of Weeraketiya- Middeniya Road and 14.48 kilometres of Tangalle- Weeraketiya Road in Hambantota district had been commenced in 2014. However, the Cabinet of Ministers had decided at its meeting held on 17 June 2015 to discontinue the rehabilitation works of such roads. Subsequently, the Cabinet of Ministers had decided on 20 April 2016 to change the scope of works and rehabilitate 80.6 kilometers of 09 national roads in Kandy and Kegalle districts and 48.25 kilometres

of other 11 rural roads in Kandy district. However, the rehabilitation works of such roads had not been commenced even as at 31 December 2016. Thus evidenced that the activities of the Project had been changed time to time and therefore, the risk on utilization of the proceeds of the Loan in timely manner for the betterment of the country cannot be ruled out in audit.

- (b) As mentioned in the previous paragraph of the report, the contracts for rehabilitation of Tangalle - Weeraketiya Road and Weeraketiya - Middeniya Road awarded to a foreign company in 2014 had been terminated in June 2015. Therefore, the rehabilitation works of 1.96 kilometres, out of 14.48 kilometres of Tangalle - Weeraketiya Road could be completed and a sum of Rs. 163 million had been paid the contractor thereon.

3.3 Extraneous Expenses

It was observed that all road rehabilitation works in the Southern Province had been carried out in 2014 in line with the proposed National Independence Day celebration scheduled to be held in Hambantota. Therefore, the additional works on the rehabilitation works of Tangalle - Weeraketiya Road and Weeraketiya - Middeniya Road had also been carried out by the Project at a cost of Rs. 72.61 million without obtaining proper authority from the respective parties. It was observed that cost incurred on additional road rehabilitation works become fruitless, as the National Independence Day celebration in 2014 had been held at the other venue.