

Hatton-Nuwara Eliya Road Improvement Project - 2015

The audit of financial statements of the Hatton-Nuwara-eliya Road Improvement Project 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 read in conjunction with Loan Agreement No. SRI-20 dated 02 November 2010 and Supplementary Loan Agreement No.SRI-26 dated 22 June 2015 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Economic Development Co-operation Fund (EDCF).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, the Ministry of Higher Education and Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objectives of the Project are stimulating socio-economic growth and development balance in the Southern Province by improving access to markets and providing employment opportunities and social services of Nuwara Eliya district. Therefore, it was proposed to improve 35.6 kilometres of Hatton - Nuwara Eliya Road, construction of Kotagala Tunnel and Nanuoya under pass Railway Bridge. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 49.92 million equivalent to Rs. 5,618 million and out of that US\$ 40 million equivalent to Rs.4,501.2 million was agreed to be provided by the Economic Development Co-operation Fund. In addition, Economic Development Co-operation Fund had provided a Supplementary Loan of US\$ 17 million equivalent to Rs.2,010.23 million to meet price escalations, costs on additional works and construction works of Kotagala Tunnel and Nanuoya under pass. The Project commenced its activities on 01 December 2011 and scheduled to be completed by 31 December 2015. The period of the Project had been extended up to 31 January 2016.

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 Financial Reporting 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 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 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 Financial Reporting 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 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, 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 Financial Reporting 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 Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Un-reconciled Balance

According to the financial statements of the Project, a sum of Rs.28.68 million had been spent during the year under review. However, corresponding amount was shown as Rs. 29.70 million in the Annual Appropriation Account of the Ministry of Higher Education and Highways.

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 Agreements		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	US\$ 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
EDCF							
i. Original	40.00	4,501.20	2,600	4.49	571.88	37.84	5,020.86
ii. Supplementary	17.14	2,010.23		14.08	1,863.93	14.08	1,863.93
GOSL							
i. Original	9.92	1,116.86	240		28.68		} 186.83
ii. Supplementary	3.34	1,055.52					
	<u>70.40</u>	<u>8,683.81</u>	<u>2,840</u>	<u>18.57</u>	<u>2,464.49</u>	<u>51.92</u>	<u>7,071.62</u>

3.2 Physical Performance

The following observations are made.

- (a) The rehabilitation works of 35.6 kilometres of Hatton - Nuwara Eliya Road from 72+000 kilometre to 115+430 kilometre commenced on 01 December 2011 had been completed with delays in 09 months and handed over to the Road Development Authority on 02 March 2015.
- (b) The Road Development Authority had taken action to award a contract to rehabilitate 3.5 kilometres of the Avissawella-Hatton Road between 68+500 kilometre 72+000 kilometre by utilizing the savings of Rs.650 million of the allocation made to the Project under the Supplementary Loan.

3.3 Contract Administration

The following observations are made.

- (a) The original estimated cost for the rehabilitation works of Hatton - Nuwara Eliya Road amounting to Rs.3,767.70 million had been revised as Rs.6,747.17 million subsequently due to design failures and additional works done. Such additional costs could have been avoided if proper attention was made by the Implementing Agency and the Consultants on designing and preparation of Bill of Quantities etc before awarding the contract. The following observations are made thereon.
 - (i) The contract for the rehabilitation works of the Road had been awarded in 2011 based on Bill of Quantities prepared in 2005. Therefore, the construction works of Kotagala Tunnel and Nanuoya underpass had been treated as the additional works for the originally estimated works under the contract.
 - (ii) It was observed that the road condition was deteriorated due to heavy vehicle moved to the construction site of the Upper Kothmate Hidro Power Station and that fact was not considered at the time of awarding the contract.
 - (iii) The processing of Supplementary Loan was completed with the delays of 17 months and as a result, the road rehabilitation works were also slow down due to delays in settling claims submitted by the contractor.
- (b) The site visits made in January 2016 had revealed that the quality of the rehabilitation works were not reached up to the accepted level of standards due to substandard compaction, narrowness of the road shoulder at 85+530 kilometre, improper shifting of telephone lines at 84+358 kilometre and improper installation of guard stones from 114+110 kilometre to 114+130 kilometre of the rehabilitated sections of the Road.

- (c) The Project had awarded a contract for the rehabilitation of the road section from 68+500 kilometre to 72+000 kilometre of Avissawella-Hatton Road to the same contractor employed for the rehabilitation of Hatton-Nuwara Eliya Road, as a variation. Eventhough a sum of Rs.598.94 million expected to be saved from main contract had been allocated for the rehabilitation of Avissawella-Hatton Road, a detailed cost estimates thereon had not been prepared. As a result, certain items of works expected to be done had not been completed.

3.4 Issues on Land Acquisitions

According to the information provided by the Divisional Secretariat of Nuwara Eliya, 494 plots of lands had been acquired and compensations thereon had only been paid for 78 plots of land as at 31 December 2015, as a result of delay in receiving the valuation reports. Therefore, the risks on incurring of additional cost on compensations thereon cannot be ruled out in audit.

3.5 Issues on Environmental Protection

According to the Environmental Management Action Plan submitted by the contractor, the procedures on environment protection laid down are required to be developed and implemented throughout the construction period. However, monthly environmental inspection reports and environmental inspection check list etc, had not been submitted by the Safety and Environmental Officer deployed by the contractor to ascertain whether the environment protection procedures were applied.