

Provincial Road Development Project (Central and Sabaragamuwa Provinces) - 2015

The audit of financial statements of the Provincial Road Development Project (Central and Sabaragamuwa Provinces) 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 Section 4 of Article III of the Loan Agreement No SL-P 96 dated 26 March 2010 entered into between the Democratic Socialist Republic of Sri Lanka and the Japan International Cooperation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Provincial Road Development Project (Central and Sabaragamuwa Provinces), then Ministry of Local Government and Provincial Councils, presently Ministry of Provincial Councils and Local Government is the Executing Agency and the Central and Sabaragamuwa Provincial Councils are the Implementing Agencies of the Project. The objectives of the Project are enhancing connectivity and reliability of the roads network especially for the people in rural areas by rehabilitating and upgrading the provincial roads and also strengthening institutional capacities of road agencies and contractors, and thus contribute to local economic development and reduction of regional disparities. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 11,171 million equivalent to Rs. 14,187 million and out of that Japan Yen 9,156 million equivalent to Rs. 11,628 million was agreed to be financed by the Japan International Cooperation Agency. The Project commenced its activities on 01 September 2010 and scheduled to be completed by January 2014. Subsequently, the period of the Project had been extended up to 31 December 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 Sri Lanka 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 identification of the purchases made out of the Loan etc.
- (d) Whether the opening and closing balance, withdrawals from and replenishments to the Special (Yen) Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether 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.
- (f) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (g) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (h) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (i) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (j) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (k) Whether 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 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 Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balance, withdrawals from and replenishments to the Special (Yen) Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,
- (d) 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,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

According to the records of the Project, 45 items of furniture and office equipment procured at a cost of Rs. 263,978 had been disposed by an auction during the year under review. However, according to the financial statements the cost of respective assets had been shown as Rs. 182,235. Further, the sale proceeds thereon Rs. 14,150 had been treated as an income of the accounts of Chief Secretary of the Central Province.

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 to be financed according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	JPY million	Rs. million		Rs. million	during the year 2015		as at 31 December 2015
				JPY million	Rs. million	JPY million	Rs. million
JICA	9,156.00	11,628.00	2,420.51	1,727.19	2,200.29	9,143.65	11,943.46
GOSL	2,015.00	2,559.00	543.92	412.93	484.32	1,353.99	1,620.31
Total	<u>11,171.00</u>	<u>14,187.00</u>	<u>2,964.43</u>	<u>2,140.12</u>	<u>2,684.61</u>	<u>10,497.64</u>	<u>13,563.77</u>

3.2 Physical Progress

The following observations are made.

- (a) The activities of the Project had been carried out under 03 phases to rehabilitate and upgrade 168.5 kilometres of 15 provincial roads in the Central Province and 181 kilometres of 18 provincial roads in the Sabaragamuwa Province. According to the Project Completion Report, the contracts awarded for rehabilitation works of 163.55 kilometres of 15 provincial roads in the Central Province and 137.53 kilometres of 17 provincial roads of the Sabaragamuwa Province were substantially completed during the period of the Project and the scope of the rehabilitation works of roads in the Sabaragamuwa Province had been reduced due to subsequent failures of the contractors and price escalations etc.,. However, the Project Director had explained that the rehabilitation works of the several provincial roads had been undertaken by the Ministry of Economic Development and as a result, the scope of the works had been reduced.
- (b) As mentioned above, according to the Project Completion Report that rehabilitation of the provincial roads were almost completed at the end of the period of the Project. However, it was observed in audit that several rehabilitations works were remained uncompleted at the end of the period of the Project due to various reasons. The instances observed are described as follows.
- (i) The rehabilitation works of 05 kilometres of Ampitiya- Uduwela Road and 6.76 kilometres of Nildannahinna -Watumulla Road in the Central Province carried out under Phase -02 of the Project at a cost of Rs.199.26 million and Rs. 330 million respectively had been subsequently abandoned due to slippage of the several sections of the roads. The consultancy services from National Building Research Organization had been obtained at a cost of Rs. 1.72 million in August 2015 for redesigning and preparation of fresh Bill of Quantities etc, and awarded contracts thereon at an estimated cost of Rs.50.28 million. However, action had not been taken to implement the

proposals made by the National Building Research Organization on improvements at the Chainage from 2+512 kilometre to 2+530 Kilometre of Ampitiya- Udawela Road and the Chainages from 18+215 kilometre to 18+265 kilometre and 23+460 kilometre to 23+ 560 kilometre of Nildannahinna -Watumulla Road even at the end of the period of the Project.

- (ii) The contract awarded on rehabilitation works of Mawela- Welange-Rukaththana Road in the Sabaragamuwa Province at an estimated cost of Rs. 255 million had been terminated due to slow progress in April 2015 after the completion of works valued at Rs. 130 million and re-awarded it to the same contractor, on the appeals made by the contractor. However, the contract had been terminated again due to failures of the contractor and awarded to other party in September 2015 at an estimated cost of Rs.115 million.

3.3 Contract Administration

The following observations are made.

- (a) Significant variations of the initially estimated costs compared with the actual costs spent on the road rehabilitation works were observed in audit. It indicated that the Bill of Quantities of respective works were not prepared based on proper ground surveys. The details are given below.

Description	No. of Packages	Cost Estimated Rs. million	Actual cost Rs. million	(Additional costs)/ Savings Rs. million
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Central Province				
Phase – I	06	2,040.0	2,050.4	(10.5)
Phase – II-I	06	1,170.0	1,152.4	17.6
Phase – II-II	10	2,298.6	2,379.2	(80.6)
Phase – III	03	59.0	56.4	2.6
Road rehabilitated by Community Based Organizations	15	3.0	28.8	(25.8)
		<u>5,570.6</u>	<u>5,667.2</u>	<u>(96.7)</u>
Sabaragamuwa Province				
Phase – I	05	1,624.4	1,567.6	56.8
Phase – II-I	05	1,700.6	1,542.8	157.8
Phase – II-II	06	1,824.3	1,598.9	225.4
Phase – III	01	255.1	130.1	125.0
Balance Work		115.5	88.4	27.1
Road rehabilitated by Community Based Organizations	10	2.0	16.4	(14.4)
		<u>5,521.9</u>	<u>4,944.2</u>	<u>577.7</u>

- (b) As a practice, the Project had paid advances directly to the material suppliers on the requests made by the respective contractors and provided undue financial gains to the main contractors. The test checks revealed that advances aggregating Rs.2 million had been released to the material suppliers during the year under review on 03 road rehabilitation works carried out in the Central Province.
- (c) Interest charges aggregating Rs. 3.31 million had been paid by the Project to the contractors who engaged in road rehabilitation works under 03 packages on delays in settling the claims made on works done by the contractors.
- (d) The site visit made by the auditors on 18 December 2015 had revealed that Uthuwankanda – Ussapitiya Road in the Sabaragamuwa Province rehabilitated and handed over to the provincial authorities on 21 July 2014 had been damaged in 22 locations by the National Water Supply and Drainage Board and action had not been taken to restore the road. It was observed that such instances could have been avoided if proper practices for coordination purposes had been maintained by the respective institutions.
- (e) The allocation amounting to Rs. 12 million made to procure a mechanically operated Bitumen Spraying Bourse had also not been utilized due to failure of selection of a capable supplier for the intended purpose.

3.4 Matter in Contentious Nature

It was observed that a sum of Rs. 29.98 million had been retained at the office of the Chief Secretary in Central Province as at 31 December 2015 to meet the probable liabilities on arbitration claims made by 03 contractors engaged in road rehabilitation works in the Central Province.

3.5 Under -utilized Assets

It was revealed that Asphalt Premix Paving Machine procured at a cost of Rs.29.82 million by the Project for the Provincial Road Development Authority of the Central Provincial Council on 14 January 2014 had been used for road works only in 05 occasions up to 31 December 2015.

3.6 Closure of the Activities of the Project

The activities of the Project had been closed as at 31 December 2015 and all eligible expenses had also been claimed and withdrawn. Further, the unspent balance of Rs.9.51 million which remained in the Special (Yen) Account at the Central Bank of Sri Lanka had been refunded on 08 February 2016. However, the handing over records required to be maintained as per Financial Regulation 753 (1) on assets handed over to the Ministry of Provincial Councils and Local Government had not been presented to the audit. Further, the action had not been taken by the Project Executing Agency to prepare and furnish wind up accounts of the Project.