

Pro-poor Eastern Infrastructure Development Project - 2016

The audit of financial statements of the Pro - poor Eastern Infrastructure Development Project for the year ended 31 December 2016 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 (8) of the Loan Agreement No. SLP 87 dated 28 March 2006 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and then Japan Bank for International Cooperation, presently known as the Japan International Cooperation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Highways, Ports and Shipping, presently 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 to restore economic foundation of the under developed eastern local economy and reduce the regional economic disparity by improving access within and outside of the Project areas through reconstruction of deteriorated and partly Tsunami affected national roads between from Akkraipattu and Thirukkondiamadu including construction of a new Bridge at Kallady in Batticaloa. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 5,569 million equivalent to Rs. 7,690 million and out of that Japan Yen 4,460 million equivalent to Rs. 6,158 million was agreed to be financed by the Japan International Cooperation Agency. The Project commenced its activities in 2006 and scheduled to be completed by September 2010. Subsequently, period of the Project had been extended up to 15 September 2013. However, the activities of the Project had been continued up to 31 December 2016 and the financial statements for the year ended 31 December 2016 had been presented for audit.

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 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 controls were adequate from the point of view of internal control so as to ensure a satisfactory control over the 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 purchases made out of the Loan etc.
- (d) Whether withdrawals under the Loan had been made in accordance with the specification laid down in the Loan Agreement.
- (e) Whether 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 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 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 in accordance with 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 Agreement had been complied with.

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 utilization of funds during the year under review and as at 31 December 2016 are shown below.

Source	Amount agreed for financing as per the Loan Agreement		Allocation made in the Budget Estimate for the year under review	during the year under review	<u>Funds utilized</u> as at 31 December 2016	
	JPY million	Rs. million			Rs. million	JP Y million
JICA	4,460	6,158	-	-	4,990	6,401
GOSL	1,109	1,532	-	-	870	1,113
Total	<u>5,569</u>	<u>7,690</u>	==	==	<u>5,860</u>	<u>7,514</u>

3.2 Physical Progress

The contract for reconstruction of 100 kilometres of the national roads in the Eastern Province and construction of new Bridge at Kallady in Batticaloa had been awarded to a foreign contractor at an estimated cost of Rs. 3,806.80 million. Therefore, the reconstruction works of 99 kilometres of Colombo-Rathnapura-Wellawaya-Batticaloa Road and Batticaloa-Thirikondiamadu-Trincomalle Road had been completed by the contractor at a total cost of Rs. 3,102.88 million. The contract for the construction of the new Bridge had been re-awarded to a state owned Corporation at an estimated cost of Rs. 813.47 million and completed at a total cost of Rs. 1,113.72 million in 2013. The foreign contractor engaged for the rehabilitation of national roads had filed an arbitration case and claimed a sum of Rs. 593.43 million due to a dispute on settling of final claims and price escalations. The Project had spent a sum of Rs. 3.28 million for arbitration proceedings, out of the contribution received from Government of Sri Lanka.

3.3 Matters in Contentious Nature

The following observations are made.

- (a) According to the direction made on 25 August 2016 by the Tribunal, a sum of Rs. 336.62 million is required to be paid by the Project within 100 days from the date of the direction with interest on payments with delays at a prevailing rate. However, the Project had not taken action up to 31 December 2016 to settle the dues.

- (b) As mentioned in my report for the previous year, income tax amounting to Rs. 9.22 million paid by the contractor on profits earned from Project activities had been reimbursed by the Project. Further, the Pay As You Earn tax amounting to Rs. 16.55 million had also been paid in 2014 on remuneration of the Consultant. However, no action had been taken by the Project even as at 31 December 2016 to recover such expenses which were made in an illegitimate manner.