

China Development Bank Funded Priority Road Project III (Phase I) - 2018

The audit of financial statements of the China Development Bank Funded Priority Road Project III (Phase I) for the year ended 31 December 2018 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 provisions in the Loan Agreement No. 4510201401100000245 dated 11 March 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation (CDB). My comments and observations which I consider should be reported to the Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Higher Education and Highways, presently the Ministry of 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 National Highway Network of the country through the rehabilitation of sections of road selected on a priority basis spread throughout the country thereby facilitating access to contribute to economic development activities. As per the Loan Agreement, 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 financed by China Development Bank. The Project commenced its activities on 09 September 2014 and scheduled to be completed by 17 June 2017. However, the completion date of the activities of the project had been extended up to 19 February 2019.

1.3 Opinion

In my opinion, except for the effects of the matters described in the Table 2.1, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2018, and of its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of management and those charged with governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Project's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Accounting Deficiency

Accounting Deficiency	Impact	Comment of the Management	Auditor's Recommendation
The contractor had claimed a compensation of Rs. 119 million for not handing over the Kandy-Jaffna road works site him on time although from that amount Rs.94 million had been decided to pay by the Dispute Adjudication Board but no provision was done in the financial statement for that compensation.	Understatement of assets and liabilities.	DAB decision is beyond parties' control and until the decision is given, amount to be paid cannot be determined. Therefore, it is unable to include the compensation amount in the financial statement.	Provisions should be made in line with the Sri Lanka Public Sector Accounting Standard No.08.

2.2 Non-Compliance with Rules and Regulations

Reference to the Laws, Rules and Regulations	Non-compliance	Impact	Responses of the Management	Auditor's Recommendation
Public Finance Circular 05/2016 and Financial Regulation No.756.	Verification of inventories had not been conducted and verification reports were not forwarded to the Auditor General.	Weaken internal control system.	Here after the inventory verification will be done at the accordance with the Public Finance Circular 05/2016 dated 31st March 2016.	Circular Instructions should be followed.

3. Physical Performance

3.1 Physical progress of the activities of the Project

Audit observation	Impact	Responses of the Management	Auditor's Recommendation
The rehabilitation works of 12 roads in extent of 248.34 km and other 04 roads in extent of 16 km by variation orders had been completed as at 30 September 2019. Meanwhile 05 roads in extent of 22.65 km of construction by variation orders are constructed up to 31 December 2019.	Possibility to incur unnecessary expenditure by the project.	Not commented.	Action should be taken to speed up the balance rehabilitation of roads works.

3.2 Contract Administration

The following observations are made.

No	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a).	Without being obtained the relevant approval from the Ministry Procurement Committee, the construction activities of Kandy Kirimatiya road of the project works which was the out of scope of the project had been completed in the year 2014 and the payment of rs.11.32 million was made on 18 July 2016.	Possibility to misuse of funds.	As per the supplement 14 to the Procurement Manual and as per FIDIC conditions of contract, even though the Project Director has the authority to approve the amount, Director General has approved the payment. And it is not necessary to obtain the approval from the Ministry Procurement Committee.	Actions should be taken to get relevant approvals.
(b).	Although the contractor required to obtain the performance Guarantee at his own cost as per the terms of the contract, by including it as a separate pay item in the BOQ, the contractor of the Marawila Udubaddawa road had entitled for undue benefit amounting to Rs. 31 million.	Undue advantage for contractors.	Otherwise, contractors add the cost of the performance security to other pay items resulting in rate increases. Therefore, payment may under the available provision in the BOQ with pay item 108.1(1) is not an extraneous payment.	Action should be taken to recover the over payment.
(c).	As per the information provided, two cracks were identified in the asphalt surface in the section from 23+850 to 23+855 at Mawanella – Hemmathagama – Gampola road. Though the notification of defects had been issued on 05 September 2019, no any corrective action had been taken until 25 December 2019.	Directly affected to durability of the road construction s.	Due to heavy rainy weather conditions in last few months, rectification work was not started. The contractor has arranged to start the rectification work on early part of the January 2020.	Corrective measures should be observed and rectified without any delay.