

Integrated Road Investment Program (i-road) - 2018

The audit of financial statements of the Integrated Road Investment Program (i-road) 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 Section 4.03 of Article IV of the Loan Agreement No.3171 - SRI (SF) for Tranch-1 dated 05 November 2014, the Loan Agreement No. 3221 - SRI and 3222 SRI (SF) for Tranche - 2 dated 28 May 2015 and the Loan Agreement No. 3325 - SRI and 3326 SRI (SF) for Tranche - 3 dated 11 December 2015 and Loan Agreement No. 3610 – SRI (SF) for Tranche - 4 dated 15 December 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. My comments and observations which I consider should be report to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Program

According to the Loan Agreements, then Ministry of Higher Education & Highways, presently the Ministry of Highways & Road Development and Petroleum Resource Development is the Executing Agency and Road Development Authority is the Implementing Agency of the Program. The objective of the Program is to enhance the road accessibility between rural communities and socioeconomic centers. The long term impact is to increase transport efficiency of national and provincial roads. As per the Loan Agreements, the estimated total cost of the Program was US\$ 906 million equivalents to Rs.117,780 million and out of that US\$ 800 million equivalent to Rs. 104,000 million was agreed to be financed by the Asian Development Bank under 06 Multi Tranche Financing Facility. The balance amount of Rs. 13,780 million is expected to be financed by the Government of Sri Lanka. The Program commenced its activities on 01 June 2014 and scheduled to be completed by 30 March 2024.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 2.1 of my report, the accompanying financial statements give a true and fair view of the financial position of the Program as at 31 December 2018, financial performance and 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 Program 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 Program or to cease operations, or has no realistic alternative but to do so.

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

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

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 internal control of the Project.
- 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	Comments of the Management	Recommendation
The total expenses of the program for the year under review amounted to Rs.10,823.16 million, as per the records maintained by the General Treasury was not agreed with the corresponding amount of Rs.12,419.59 million shown in the financial statement of the Program.	Unreconciled balances remained in the financial statements.	The unaccounted balance of Rs.1,596.43 million reported to the External Resources Department after being closed the Ledger Accounts of the General Treasury.	The correspondence balances in the financial statements should be reconciled periodically with the records of the General Treasury

2.2 Non-Compliance with Laws, Rules and Regulations

No	Reference to the Laws, Rules and Regulations	Non-compliance	Impact	Comments of the Management	Recommendation
a)	Section 4.17 of the Conditions of Contract.	According to the said condition, the contractor shall be responsible for all equipment of the contractor brought to the site deemed to be used for the execution of the works and not to be removed from the site without the consent of the Site Engineer. However, the machineries, equipment etc. occupied by the contractor involved in the rehabilitation of rural roads in the Sabaragamuwa Province under 03 packages had been demobilized without the consent of	Possible risks on recovering of advances made.	Not properly responded	Action should be taken to resolve the matter without disputes and identify the responsible parties thereon.

the Road Development Authority, after making the recommendation by the Project Director on 16 October 2018 to terminate the aforementioned contract.

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| b) | Section 4.17 of the Conditions of the Contract. | The mobilization advances amounting to Rs.304.23 million had been made to a contractor involved in the rehabilitation of roads in Kegalle district over the advance guarantee valued at Rs. 30.26 million. | Undue favouration made to the contractor and the recovery of the advances would not be possible. | Action has been taken to recover the Advance. | Action is required to be taken to obtain guarantees to cover the advance completely. |
| c) | Section 4.17 of the Conditions of the Contract. | According to the Conditions of the Contract, the separate field laboratory is required to be established under each contract packages. However, a single field laboratory had been established for the testing purposes by the contractor involved in road rehabilitation works under in Kalutara district. | Quality assurance mechanism would be weakened due to limited sample tests. | Contractor has provided one field laboratory and it is sufficient to carry out the tests in line with the current progress. The other will be provided later once it is necessary. | The contractor should be influenced to carry out regular tests in order to assure the quality of works and the quality control mechanism should be monitored by the Project. |

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| d) | Sub Clause 14.6 of the Condition of Contract. | The minimum amount of interim payments to be submitted by the contractor was determined as 1.5 per cent of the value of the contract. However, there were 102 instances of evaluation of Interim Payment Certificates under 21 packages below than the required threshold. | Overrunning of cost on evaluation of Interim Payment Certificates. | There was a decision by the Employer to recommend payment based on the progress to improve the cash flow of the contractor as the provision in the contract is not a mandatory. | It is required to adhere with the thresholds stipulated in the condition of contract in order to minimize the costs, time and undue favouration for the contractors. |
| e) | Sub clause 1.14 of the Condition of Contract | According to the sub clause, if the contractor constitutes joint ventures, consortiums or other unincorporated grouping with 02 or more persons, these persons shall be deemed to be jointly and severally liable to the employer for the performance of the contract. However, the contractor involved on rehabilitation of roads in Kalutara district under 02 contract packages had constituted a joint venture with a foreign partner and no evidence received for the participation of the representatives of the foreign partner for the progress review meetings to undertake responsibilities on implementation of the activities of the Project. | The responsibilities of the partners of the joint venture could not be defined. | The Employer had taken actions to summon the joint venture partners. | The Road Development Authority should take action to summon all the partners of the joint venture for the progress review meetings. |

3. Physical Performance

3.1 Physical Progress of the activities of the Project

No	Component	Auditor's Comment and observations	Impact	Comments of the Management	Recommendation
(a)	Rehabilitation of National Roads	According to the initial plans, the road rehabilitation works of 400 kilometres of national roads were expected to be rehabilitated. However, the length of the national roads had been reduced up to 284.52 kilometres due to changes of the scope of the works under the Program. Out of that contracts for rehabilitation of 25 kilometers of Maradankadawala - Habarana Road had only been awarded during the year under review after lapse of 03 years from the date of commencement of the activities of the Program.	Possible increase of costs due to delays in completion of construction works	Awarded the contract on rehabilitation of the section of Maradankadawala - Habarana Road on 05 June 2019 and preliminary survey and design works of other roads are in progress.	The contractors are needed to influence to achieve the time targets to avoid the cost increase and extension of the period of the contracts.
(b)	Rehabilitation of Provincial Roads	According to the action plan, 3,033.58 kilometers of rural roads in Southern, Central, Sabaragamuwa, North Western and North Central provinces and Kalutara District in Western Province scheduled to be rehabilitated. The progress on roads rehabilitate in provinces are given below.		Eventhough the progress of rehabilitation works remained slow as at 31 December 2018 action had been taken the expedite the works.	

<u>Province</u>	<u>Rehabilitation works of rural roads</u>			<u>Reasons</u>
	<u>Expected</u>	<u>Achievement as at 31 December 2018</u>		
	Date to be completed	km	km	
Southern	17 May 2017	588.50	542.40	Due to poor performance of the contractors
Central	15 December 2017	582.21	542.40	
North Western	31 July 2018	610.97	434.43	
Sabaragamuwa	15 December 2017	274.27	323.88	
Kalutara	24 July 2018	269.41	121.27	

3.2 Contract Administration

No	Audit Issue	Impact	Comments of the Management	Recommendation
a)	It was observed that the progress of the contractors involved in rehabilitation works of 183 kilometers of the roads in Kalutara district under 02 contract packages of had remained behind the targets due to financial difficulties faced by the contractor. It was observed that the Road Development Authority had not taken action to assess the financial capacity of the contractor at the time of awarding of the contracts. As a result, the mobilization advances aggregating Rs. 560.97 million made to the contractor had remained unrecovered as at 31 December 2018.	Probable failure of the completion of road rehabilitation works.	Necessary actions have been made to thorough evaluation of financial capacity of the bidders in future and maximum efforts have been taken to recover the outstanding balance of mobilization advance.	Action should be taken to recover the dues.

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| b) | The road rehabilitation works under 15 packages in the Sabaragamuwa and Central provinces had shown slow progress and as a result, mobilization advances aggregating Rs 2,969 million had remained unrecovered after lapse of 05 months from the date to be completed up to as at 31 December 2018. | Probable losses due to weaken contract administration. | Recovery is affected due to lack of progress of works | Action should be taken promptly by the Project to recover the outstanding balances. |
| c) | Out of 4,031 public complaints in Sabaragamuwa, Central and Kalutara District in Western Province in relation to the rehabilitation of rural roads, 707 complaints are remained unsettled as at 28 March 2019 without being taken early actions. This includes 145 instances of damages of the residencies due to road rehabilitation works. However, the insurance related documents thereon had not been presented for the audit. | Possible public protest and failures of road rehabilitation works. | Majority of Public complaints have been fully resolved and the balance was being attended as at 31 May 2019. | Action should be taken by the Executing Agency to address the expectations of the stakeholders. |

3.3 Observations made on site visits

No	Audit Issue	Impact	Comments of the Management	Recommendation
a)	It was observed that the key positions of the staff deployed by the contractor involved in the road rehabilitation works in Kalutara district under the contract package - 02 such as Project Manager, Deputy Project Manager, Highway and Pavement Design Engineer, Quality Assurance Manager, Structural Engineer, Site Engineer Quantity Surveyor, Surveyor, Assistant Surveyors and Environment and Safety officers had remained vacant for a year which affected to the smooth operations of the activities of the Project. Further, it was revealed at field visit	Entire process of the contract administration activities under the contract package would be failed due to shortage of key personnel of the staff of the contract.	Engineer has issued notice to the correct under Sub Clause 15.1 of the Contract.	The Project Monitoring Unit should implement strong action against the contractor and make influence to deploy adequate staff for the operations of the works under the contract.

carried out on 25 February 2018 that the contractor had not deployed adequate laboratory staff and helpers enable to carry out the field tests to maintain the quality status of the roads rehabilitated in Kalutara district.

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| b) | The contractor had overlaid asphalt at the existing box culvert and constructed bell mouth widening of the section of the first 21 kilometres f Weralla Junction to Narammala - Thambarawa Road in the North Western Province without a design approved by the Road Development Authority for widening the culvert. | Problems in vehicle movements would be arisen. | Considering the contractor's convenience, the Engineer has allowed to continue laying asphalt concrete with the intention to widen culvert and bell mouth later. | The Project Monitoring Unit should take action to investigate the matter. |
| c) | The site visits made on 1 July 2018 at Wilawa Junction to Kubukwewa road in the North Western Province had revealed that the asphalt laid was remained at the compaction of the asphalt surface ranging from 92 per cent to 96 per cent below the standard level of 97 per cent. Thus evidenced that the quality assurance mechanism had not been applied thereon. | Possible problems in road worthiness. | It was issued to reduce the percentage of required minimum degree of compaction of Asphalt with the consultation of experts of the matter due to low traffic density on rural roads. | The Project Monitoring Unit should take action to investigate the problems in the quality assurance process in order to identify the responsible parties. |

3.4 Extraneous payments

Audit Issue	Impact	Comments of the Management	Recommendation
According to the information received, commitment charges amounting to Rs. 475.94 million had been recovered by the Lending Agency as at 31 December 2018 on undisbursed proceeds of Loan.	The allocation would not be utilized for intended purpose.	Commitment Charges on unutilized balance will be entitled after the effective date of the Loan as per the Loan Agreement.	Action should be taken to minimize the unnecessary costs.

3.5 System and Controls

No	Audit Issue	Impact	Comments of the Management	Recommendation																				
a)	It was observed that the Bill of Quantities and Engineer's Estimates etc of rehabilitation of 74.09 kilometres of the roads in Puttalam district under package No PU-02 had not been prepared properly and the works under items which were not included in the Bill of quantities had been implemented at arbitrarily determined rates as shown in the following table.	Possibility to increase the cost of contract.	The contractor shall be responsible for conducting all topographical and other necessary surveys and design activities to establish and execute the final design of the Project as require under the Contract. Hence, some new items and rates may be expected depending on the Contractor's design and his methodology of work.	The Project Monitoring Unit should take action to investigate the problems in bid evaluation process in order to identify the responsible parties.																				
	<table border="1"> <thead> <tr> <th>Pack age No</th> <th>Description</th> <th>Unit</th> <th>Rate (Rs)</th> </tr> </thead> <tbody> <tr> <td>PU2</td> <td>Removal of trees-Girth over 2000 mm</td> <td>Nr</td> <td>20,000</td> </tr> <tr> <td></td> <td>Lining of Drains screed, concrete grade 15(20)</td> <td>Cu.m</td> <td>18,000</td> </tr> <tr> <td></td> <td>Lining of drains with concrete grade 25(20)</td> <td>Cu.m</td> <td>22,000</td> </tr> <tr> <td></td> <td>150 mm thick precast concrete cover slab including reinforcement and form work</td> <td>Sq.m</td> <td>6,000</td> </tr> </tbody> </table>	Pack age No	Description	Unit	Rate (Rs)	PU2	Removal of trees-Girth over 2000 mm	Nr	20,000		Lining of Drains screed, concrete grade 15(20)	Cu.m	18,000		Lining of drains with concrete grade 25(20)	Cu.m	22,000		150 mm thick precast concrete cover slab including reinforcement and form work	Sq.m	6,000			
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175 mm thick precast concrete cover slab including reinforcement and form work	Sq.m	7,200
Concrete encasement of pipes	Cu.m	20,000
Reinforce concrete pipe 450 mm diameter including reinforcement and form work	Li.m	9,000

- (b) According to the Public Contract Act, No 03 of 1981, the foreign contractor who undertake contract with collaboration of local partner should be registered at the Registrar of Public Contract. However, the Road Development Authority had not taken action to verify the registration of 02 firms of contractors from China and India engaged in road rehabilitation works of North Western Province and Kalutra District with collaboration of the local contractor. However, the respective contracts in Kurunegala district had been subsequently terminated due to poor performance of the contractor and not taken any action to recover the mobilization advance amounting to Rs. 683.18 million.
- Problems would arise on taking legal actions.
- It is intended to recover the mobilization advance balances and take action taken against the Contractors.
- Prompt action is need to be taken by the Project monitoring Unit to recognize the responsible parties and take action on negligence on adhering of the circular instructions.

3.6 Matters pointed out in Previous Audit Reports which remained unresolved

No	Audit Issue	Impact	Comments of the Management	Recommendation
a)	It was observed that a local contractor engaged in rehabilitation of rural roads had unduly claimed the concessions stipulated in the Circular No TIP/TP/08/53/2016-69 of 05 September 2016 of	Misuse of funds and violation of circular	This tax concession had been granted by the Department of Fiscal Policy for the Contractors of	Immediate action needed to be taken to investigate the matter.

the Department of Trade and Investment policy and imported machineries and equipment valued at Rs. 324 million under tax free concessions and with the agreement of re-exporting of such machineries and equipment after completion of the road rehabilitation works. However, the Program had not adopted a proper mechanism to monitor the usage of such machineries for the intended activities stipulated in the contract packages. Further, the contractors in those packages were unable to perform his contracts and Program had not taken any action to check whether those item re-exported or not.

instructions.

the Integrated Road Investment Program in consideration of it as a national development Project.

- b) Although contractor shall obtain a performance security at his own cost for the proper performance of the contract as per the sub clause 4.2 General Condition of the Contract, it was observed that Project had included a separate pay item in the Bill of Quantities contrary to the above mentioned requirement, by allowing contractors to quote for cost of providing performance guarantees which should be borne by the contractor at his own cost due to wrong interpretation at the preparation of bidding documents by the Procurement Entity. Accordingly, a sum of Rs. 608. 60 million had been paid to the contractors

Undue advantage for contractors.

Sub Clause 4.2 of General Condition was amended in packages of Eastern, Northern and Western Provinces accordingly and pay item in the BOQ was removed.

Action should be taken to recover the over payment.