

Integrated Road Investment Program (i-road) - 2019

The audit of financial statements of the Integrated Road Investment Program (i-road) for the year ended 31 December 2019 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 the Ministry of Higher Education & Highways, presently the Ministry of Roads and Highways 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 equivalent 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. Out of that 04 separate loan agreements had been signed up to 31 December 2019 to finance US\$ 557 million equivalent to Rs.72,410 million under 06 Tranches and other Loan Agreements are expected to be signed in 2018 and 2020 to finance US\$ 243 million equivalent to Rs.31,590 million under other 02 Tranches. Out of the aforementioned 04 Tranches Loan no 3222 SRI (SF) and 3326 SRI (SF) of Tranch 03 had been closed on 07 April 2017 and 27 March 2017 respectively. The balance amount of US\$ 106 million equivalent to 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 2019 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 fund received, 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 Deficiencies

No	Accounting Deficiencies	Impacts	Responses of the Management	Auditor's Recommendations
(a).	Some of the fixed asset procured under the bill of quantities which belongs to the completed contact packages of North Central, Sabaragamuwa, North Western and Central Provinces had been handed over to the Road Development Authority as at 31 December 2019. However, the Program had not been maintained proper records to identify the value of those assets transferred to Road Development Authority except the vehicles valued at Rs.559.64 million of the North Central, Sabaragamuwa and North Western Provinces and Kalutara district in Western Province. Hence, the Program had not been accounted the value of those handed over assets. As a result, the value of work-in- progress had been overstated by that amount.	Overstatement of work –in progress.	Assets records handed over to the RDA are available in the Project. Valuing process will be implemented by appointing committee with the discussion of RDA officials and accounting will be made accordingly.	Necessary action should be taken to identify the value of the assets handed over and accounted in proper manner.
(b).	Although 613 rural roads with the length of 2,009.75 km constructed by the program had been handed over to the Road Development Authority as at 31 December 2019, the cost thereon had not been recognized as assets in accordance with Sri Lanka Public Sector Accounting Standard -01	Understatement of Non-Current assets.	The cost of construction of individual roads could be correctly given only after the above taking over process completed.	Assets should be recognized in line with Sri Lanka Public Sector Accounting Standard 01.

2.2 Non-Compliance with Laws, Rules and Regulations

No	Reference to the Laws, Rules and Regulations	Non-compliances	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	Sub Clause 4.2 of the General Condition of the Contract	The separate pay items had been made in the Bill of Quantities on road rehabilitation works by allowing contractors to quote the cost of providing performance guarantees, contrary to the provisions made under the sub clause 4.2 of the General Condition of the Contract to obtain performance security bonds at cost of respective contractor. Accordingly, a sum of Rs. 608.6 million had been paid additionally to the contractors to reimburse the cost of performance security bonds obtained by the contractors. Further, actions had not been taken to recover that amount from the contractors even up to 31 December 2019.	Undue advantage for contractors.	As the Contract was awarded based on Quoted Contract Price (substantially lowest evaluated Contract Price). This amount cannot be considered as a loss. However, Sub Clause 4.2 of General Condition was amended in packages of Eastern, Northern and Western Provinces. Accordingly, pay item in the BOQ was removed.	Action should be taken to recover the over payment.
(b)	Sub Clause 14.6 of the Condition of Contract	Minimum amount of Interim Payment Certificate to be submitted by the contractor was 1.5 per cent of the value of the contract. However, it was observed that 36 instances where evaluation of Interim Payment Certificates under 12 packages less than the required threshold.	Overrunning of cost on evaluation of interim payment.	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 favours for the contractors.

- (c) Sub Clause 14.10 of General Conditions of Contract Within 84 days after receiving the taking over certificate for the works, the contractor shall submit the statement of completion report to the engineer with supporting documents in accordance with Sub Clause 14.3. Though, 2,009.75 km length of 613 roads were completed as at 31 December 2019, such statement of completion reports were not made available to the audit. As a result, the cost of the completed roads could not be ascertained
- Unable to ascertain cost of the completed roads.
- Once the taking over is completed and with the Statement at Completion (SAC), the road wise construction cost could be prepared.
- Action should be taken to obtain statement at completion after receiving taking over certificates.
- (d) Sub clause 20 of the Consultancy Agreement It was planned to deploy Engineers and Technical Officers of the Road Development Authority and the Provincial Councils of the Sabaragamuwa, Central and Western Provinces for knowledge transfer purposes and the capacity development of the Road Work Agencies. However, the Technical Officers of the contractors engaged for road rehabilitation works had been deployed by the program instead of deploying the officers from respective agencies.
- It will lose the opportunity to enhance the knowledge and capacity development of Engineers and Technical Officers of the Road Development and other respective agencies.
- During the initial period of project implementation, the relevant Provincial Councils were requested to release Engineers and Technical Officers to the project for the purposes of knowledge transfer and capacity development. Since there had been no response from Provincial Councils, the Consultants were allowed to employ Engineers and Technical officers to fulfill the urgently required site supervision personnel.
- Necessary action should be taken to get the maximum benefit on knowledge transferring.

3. Physical Performance

3.1 Physical Progress of the activities of the Project

No	Component	Audit Observations	Impacts	Responses of the Management	Auditor's Recommendations
(a)	Rehabilitation of National Roads	According to the initial plans, the rehabilitation works of 400 km of national roads and 3,117.62 km of rural roads in the Southern, Central, Sabaragamuwa, North Western and North Central Provinces and Kalutara district in the Western Province were expected to be carried out during the period of the Program. However, as per the progress reports, out of 400 km of national roads, 25 km of Maradankadawala - Habarana road under RMC/03 package and 52 km of Karapitiya- Labuduwa-Thawalama Road under RMC-SP1 package had only been awarded during the year under review after lapse of 04 years from the date of commencement of the activities of the Program. It is questionable that the program could be initiated the balance rehabilitation works of 323 km of national roads along with the rehabilitation of rural roads before the end of the Program period.	Possible increase of costs due to delays in completion of construction works.	Could not be proceed National Roads as initial plans due to changes of priorities, frequent changes of road list etc. However, Works have been scheduled to complete at least 400 km before expiration of the Program.	Necessary action should be taken to comply with the original plan and complete the rehabilitation works of National Roads along with the rural roads.
(b)	Rehabilitation of Rural Roads	The rehabilitation works of 2,651.06 km of rural roads in the Southern, Sabaragamuwa, Central, North Central and North Western Provinces and Kalutara District in Western Province had been completed as at 31 December 2019. Although 2,651.06 km of rural roads had been completed, only 2,009.75 km of 613 rural roads had been handed over to the Road Development Authority. Out of 3,117.62 km of rural roads under 42 packages, 986.56 km length of rural roads relevant to 12 contract packages had been	Possible increase of costs due to delays in completion of construction works.	The 12 Contracts referred to had to be terminated due to poor performance by the Contractors followed by taking necessary contractual measures as spelt in the Conditions of Contract. However, the Project has	Financial and working capacity of the new bidders should be properly evaluated before awarding contracts.

terminated without being completed as at 31 December 2019.

taken action for re-bidding for five of the above Contracts and the Contractors have indicated their intention to look forward in continuation of work in the balance Contract.

3.2 Contract Administration

No	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	A sum of Rs. 146 million had been obtained as a special loan from the Road Development Authority and utilized Rs. 10 million during year under review in addition to loan funds. Further, due to insufficiency of funds from General Treasury, the above Rs.10 million had been obtained without been obtained the approval from the General Treasury or the Secretary of the Line Ministry. However, the reasons for the necessity of additional financing of Rs. 136 million from the Road Development Authority as at 31 December 2018 and the approval for that were not submitted to the audit.	Possibility to misuse of additional finance.	A sum of Rs.10 million had been obtained from Road Development Authority due to insufficient of GOSL fund to meet urgent payment for the month of October 2019, and the approval has been given by the Chairman RDA. Amount of Rs. 10 million will be settled to RDA after receiving the GOSL Fund requested from the Ministry. A special Loan amounting of Rs. 136 million released by the RDA out of NSB Loan Facility obtained. Settlement process is handled by the RDA, once the settlement details received to the Project Corresponding entries will be made accordingly.	Action should be taken to maximum use of funds of the loan and avoid obtain additional financing facilities.

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| (b) The Program could not recover a sum of Rs.3,734.79 million of the mobilization advance paid to the contractors and a sum of Rs.2,618.47 million of the performance bond kept by the contractor, due to the legal actions had been taken by 12 contractors against the Program. | Probable losses due to weaken contract administration. | The recovering of the amounts could be effected in the termination claims once finalized. As per Contractually Provision, Project had issued Letters of Demand to respective Banks of all 12 Contracts to encash Guarantee Bonds of Mobilization Advances. However, due to Court Order this process has been temporally suspended. | Action should be taken promptly by the Program to recover the outstanding balances. |
| (c) Rs. 92 million had been paid to another contactor (KU 01) for the emergency work completed to use the roads at minimum risk due to abandoned of works by another 02 contactors (KU 03 and KU 05) which terminated subsequently in North Western province. However, any action had not been taken by the programe to recover the additional expenditure incurred from the respective contractors. | Probable losses due to weaken contract administration. | Additional expenditure incurred by the Employer due to transferring emergency and safety works in terminated Contracts KU 3 and KU 5 to a performing Contractor has been fully included in the “Employers’ Claims” for KU3 and KU5 packages. | Necessary action should be taken to recover the additional expenditure incurred from the respective contractors. |
| (d) A sum of Rs. 23 million had been paid in order to pay the salaries, allowances, housing and office facilities and vehicle maintenance of employer’s and engineer’s staff attached to the rehabilitation of contract packages of KU3, KU4, KU5, PU2, PU3 in North Western province which were abandoned by respective contractors by issuing variation orders to the Bill of Quantities of the performing another 03 contactors. Therefore, these cost incurred without being attended to the construction works during the year under review will be an additional cost to the Program. | Probable losses due to weaken contract administration. | Most of the project key staff of the Engineer and the Employer and their facilities have been provided through eight contract packages considering them as a single Project in NWP. Hence, the staff commonly administers and manages the whole Project. On the other hand, even after termination of contract packages some of the staff and facilities were compulsorily required for post termination activities.

In addition to that all relevant additional cost to the Employer due to extra periods of deployment of staff too has been included in the Employer’s Claim. | Necessary action should be taken to complete the task without delay. |

3.3 Observations made on site visits

No	Audit Issues -----	Impacts -----	Responses of the Management -----	Auditor's Recommendations -----
(a)	<p>According to the first component of the Program, the rural access roads have to be rehabilitated to meet all weather standards and to be maintained for a period of three years. However, on the physical inspection made on 27 November 2019, it was observed that some cracks on the asphalted surface of the roads, washed away and submerged some of the locations of the roads slightly from Kasikotte Junction to Peella via Meeoya Bridge and the Nelumpatuwewa to Ududivulwewa road in the Kurunegala District under the package KU 04. Subsequently, those roads had been fully destroyed by the recent flood were observed on 13 May 2020. Therefore, it was revealed that the objective of the component had not been fulfilled by the Program.</p>	<p>Objective of the project may not achieved.</p>	<p>It was observed some cracks appeared on asphalt surface during a severe dry period after one year of construction. Due to unforeseeable rains with very high intensity during December 2019, some of the sections of RD ID 16 and RD ID 96 roads submerged. We observed some cracks and washed off sections on above roads and reported to the Engineer.</p> <p>By the time of above damages, the Contract had been terminated. Since there was no live contract, we had no chance of rectifying damages through the Contractor with his own cost or through the Insurance cover.</p> <p>However, since the whole responsibility of designs are with the Contractor and due to the impossibility of rectification through the terminated Contractor, all the payments previously made relevant to damaged road sections were deducted from the Contractor in Valuation of Termination (VAT). In addition to that, possible additional cost to the Employer too was included in the Employer's Claims.</p>	<p>Necessary action should be taken to rectify the construction issues and certify the quality of the roads.</p>
(b)	<p>Although, the rehabilitation works of the road from Mawiela junction to Thelibewa Temple road via Ilukpitiya with the length of 7.5 km had been completed, provision for reconstruction of bridge in the Bill of Quantities had not been included at the time of preparation of BOQ under the contract package- 01 of</p>	<p>Objective of the project may not achieved.</p>	<p>Bridge construction items have not been included into KU1 BOQ. But, on highly dilapidated minor bridge with 3 spans on Rd ID 33 at ch: 4+814 was done for the convenience and safety of the road users with suitably adjusted rates at the later stage of the project using available savings at that time.</p>	<p>Necessary action should be taken to rectify the construction issues and certify the quality of the roads.</p>

the Kurunegala District. As a result of fail to reconstruct the bridge, the quality of the whole reconstructed road works had been badly affected.

3.4 Extraneous payments

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
According to the information received, commitment charges amounting to Rs.1,180.44 million had been paid to the Lending Agency as at 31 December 2019 on undisbursed proceeds of the Loan of Asian Development Bank, due to slow progress and termination of some contractors.	The allocation would not be utilized for intended purpose.	Commitment Charges on unutilized balance are applicable 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

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
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, Action had not been taken by the Road Development Authority 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 under packages KU3 and KU5 in Kurunegala district had been subsequently terminated, due to the capacity of the contractors had not been properly evaluated by the program at the initial stage which lead to poor performance.	Problems would arise on taking legal actions.	According to the ADB guidelines, Contractors had been selected as contracting Companies registered in an ADB member country.	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 circular instructions.

3.6 Matters pointed out in Previous Audit Reports which remained unresolved

No	Audit Issues -----	Impacts -----	Responses of the Management -----	Auditor's Recommendations -----
(a)	The mobilization advances amounting to Rs. 304.23 million had been paid to a contractor involved in the rehabilitation of roads in Kegalle district over the advance guarantee valued at Rs. 30.26 million. Further, any action to recover this overpaid amount had not been taken by the Program even up to 31 December 2019.	Undue favouration made to the contractor and the recovery of the advances may not be possible.	This is one of the Contracts terminated due to poor performance and actions will be taken to settle this amount along with the termination claim.	Action should be taken to recover this overpaid amount.
(b)	Local contractor engaged in rehabilitation of rural roads had unduly claimed the concessions given in the Circular No TIP/TP/08/53/2016-69 dated 05 September 2016 of the Department of Trade and Investment Policy by imported machineries and equipment valued at Rs. 324 million under tax free concessions with the agreement of re-exporting of such machineries and equipment after completion of the road rehabilitation works. However, the Program had not been 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 their contracts due to lack of financial capacity and Program had not taken any action to ratify whether those item re-exported or not.	Misuse of funds by violation of circular instructions.	This tax concession had been granted by the Department of Fiscal Policy for the Contractors of the Integrated Road Investment Program in consideration of the project as a National Development Project.	Action should be taken to investigate the matter.