

China Development Bank Funded Priority Road Project 3 - (Phase II) - 2020

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase II) for the year ended 31 December 2020 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. 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 Facility Agreement of the Project, then Ministry of Higher Education and Highways, presently the Ministry of Transport and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to reconstruct/rehabilitate existing national roads and rural roads providing crucial accessibility and quality of transport infrastructure and services to provide number of social and economic benefits to the people who living in the area. As per the Loan Agreement, the estimated total cost of the Project was US\$ 117.66 million equivalent to Rs.15,594.14 million and out of that US\$ 100 million equivalent to Rs.13,253 million was agreed to be provided by China Development Corporation of China.

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 Project as at 31 December 2020 and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting standards.

1.4 Basis for Qualified 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.

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

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 Deficiencies

No	Accounting Deficiencies	Responses of the Management	Auditor’s Recommendations
(a)	Contrary to Paragraph 36 of Sri Lanka Public Sector Accounting Standard No. 05, exchange differences arisen in foreign operations had not been recognized under net assets of the project. Accordingly, work in progress had been understated by Rs.377.8 million as at 31 December 2020.	Action will be taken to record the exchange rate differences under the net assets as per the Sri Lanka Public Sector Accounting Standard No.05.	Exchange differences arose in foreign operations should be recognized under net assets of the project.
(b)	The provision had not been made in the financial statements for the risk premium fee required to be paid as per the Section 3(5.5) of the loan proceeds disbursement agreement on the unutilised amount of USD	Project had been suddenly closed by 31 December 2020 and unutilized loan balance as at 31 December 2020 was US \$ 82,814.26.	Provisions should be made as per Sri Lanka Public Sector Accounting Standards No 08.

82,814.26 remained as at 31 December 2020. The provision for the risk premium fee has not been provided in the financial statement as project does not have any provision for risk premium fee.

3. Physical Performance

3.1 Physical Progress of the Activities of the Project

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Though the road improvement works in Mawanella town in Colombo - Kandy road was completed on 05 November 2020, instead of paying final payments for the construction Rs.287.35 million had been paid as an advance payment to contractor and obtained guarantee from a bank for the balance works at site as at 31 December 2020. Further, noted that the amount was recorded under the work in progress of the project.	Sudden decision of donor to stop the fund after December 2020, had been created adverse impact to ongoing work and physical condition of the work were very crucial to stop or terminate as it was. With the information of that decision, political authorities in the area as well as all the government institution, local authorities and business communities at Mawanella town had made a big pressure on RDA to complete the committed task in order to get success of town development plan.	Action should be taken to speed up the balance rehabilitation of roads works and avoid to provide such benefits to the contractors in future contracts.
(b)	The road improvement works of Kegalle - Bulathkohupitiya - Karawanella Road 1.5km section was commenced on 06 August 2020 with the contract value of Rs.240 million. However, as per taking over certificate, only 500 m could completed, due to the closure of funding arrangement. It was further observed that a sum of Rs.55.9 million had been paid to the contractor subject to a Bank guarantee for the balance works at site as at 31 December 2020 and recorded under work in progress.	Due to the sudden closure of funding arrangement by donor, there was a crucial situation to the progressive work and it had been created many difficulties to the road users surrounding area. Accordingly, it was decided to identify the critical activities which are progressing at the site and decision has been taken to improve the 500m road section including Bulathkohupitiya fair in order to minimize the inconveniences caused to affected parties.	Action should be taken to speed up the balance rehabilitation of roads works and avoid to provide such benefits to the contractors in future contracts.

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| <p>(c) Though a sum of Rs.14.4 million made to the contractor, the construction of the pedestrian overhead bridge had not been completed and it had stopped the design construction works of the bridge halfway as at 31 December 2020.</p> | <p>At the time of donor informed to stop the ongoing loan for this project, all the design proposals had been completed and handed over to the contractor in order to proceed the construction works.</p> | <p>Necessary action should be taken to complete the balance works.</p> |
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3.2 Contract Administration

The following observations are made.

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	According to the Sub Clause 14.6 of the Particular Condition of Contract, minimum amount of Interim Payment Certificate to be submitted by the contractor was 1.5 per cent of the accepted Contract value. However, 19 instances were observed where the evaluation of Interim Payment Certificates below than the required threshold as at 31 December 2020.	In some cases the payment based on Contractor's request had to be considered to maintain the project cash flow even though it is below than the required threshold.	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.
(b)	Contrary to Sub Clause 14.9 of General Conditions of Contract, Rs. 41.2 million had been paid as retention money related to 4 construction works before the expiry date of defect notification period under a Bank guarantee.	Due to the termination of loan for this project by end of December 2020, it is considered that final disbursement period as the 31st December 2020. Accordingly, with the certification of the Engineer 2nd half of Retention had been released keeping a guarantee.	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

3.3 Observations made on site visits

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	During the field inspection on 19 July 2021, it was observed that wood carvings designed for the overhead bridge which should have been provided by the contractor and steel beams and columns valued at Rs.7.5 million had been stockpiled at the sub contractor's places without utilizing for an effective task.	That has been focused to utilize for effective works. However, since the balance work of the project will be considered to resume under the Hunan Project funds, those steel, beams and columns could be utilized for the same.	Necessary action should be taken to use those purchased wood carvings, steel beams and columns for the intended purpose.
(b)	Though the project had wound up, there were no any further action had been taken to complete of construction works of the bridge. Therefore, without achieving the objective, the contractor had been undue benefitted by payments made to the contractors and by allowing to keep the construction materials at the end of the project.	Balance works will be considered to resume under the Hunan Project funds with the approval of the relevant procurement authorities.	Necessary action should be taken to use those purchased wood carvings, steel beams and columns for the intended purpose.