

National Highways Sector Project (Additional Financing) - 2014

The audit of financial statements of the National Highways Sector Project (Additional Financing) for the year ended 31 December 2014 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 2.09 of Article II of the Loan Agreement No. 2767 SRI dated 04 October 2011 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank .

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Highways and Ports, presently the Ministry of Highways and Investment Promotion is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve the national transport efficiency by upgrading rehabilitation and realignment of about 60 kilo metres of National Highways. As per the Loan Agreement, the estimated total cost of the Project was US\$ 105.6 million equivalent to Rs.13,728 million and out of that USD 85 million equivalent to Rs.11,050 million was agreed to be financed by the Asian Development Bank. This Project is implemented to provide additional finance for simultaneous Project called National Highways Sector Project implemented under the Loan Agreement No. 2217 SRI dated 14 December 2006 entered into between the Government of Sri Lanka and Asian Development Bank which was completed on 31 December 2012. Even though these two projects are administered by the same Project Monitoring Unit, the financial statements for the year ended 31 December 2014 for respective Projects are submitted separately. The Project commenced its activities on 14 December 2011 and scheduled to be completed by 31 December 2015.

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 Sri Lanka 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 and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over 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 identifications of the purchases made out of the Loan, etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the 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 Sri Lanka 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.

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 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Sri Lanka Public Sector Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided.
- (c) the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement.
- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 **Comments on Financial Statements**

2.2.1 **Non - Compliance with Laws, Rules and Regulations**

The following instances of non-compliance were observed in audit.

- (a) Although the Project employees are not entitled to receive any other allowances other than the payments allowed to withdraw as per the paragraph 8.3.9 and 8.6 of the Circular No.PED/12 dated 02 June 2003 of Department of Public Enterprises, the officers of the Road Development Authority attached to the Project had been paid special allowance and encashment of medical leave amounting to Rs.9,918,622 and Rs.776,316 respectively during the year under review, contrary to the instructions of the Circular.

- (b) As a practice, the salaries of employees of the Road Development Authority who attached to the Project are paid based on the formula introduced by the Road Development Authority, contrary to the instructions of the Circular No.33 of 05 April 2007 of the Department of Management Services.
- (c) In addition to above, a sum of Rs.2,354,794 had been remitted to the Road Development Authority by the Project as overhead charges, contrary to the instructions made in paragraph 8.3.9 of the Circular No. PED/12 of 02 June 2003 of the Department of Public Enterprises.

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed for financing according to the Loan Agreement		Allocations made in the Budget Estimate for the year under review		Funds utilized up to 31 December 2014	
	USD million	Rs. million	USD million	Rs. million	USD million	Rs. million
ADB	85.0	11,050	22.6	2,939.3	51.2	6,661.9
GOSL	20.6	2,678	6.7	867.7	24.5	3,188.1
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	105.6	13,728	29.3	3,807.0	75.7	9,850.0
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According to the above information, 60 per cent of the proceeds of the Loan had only been utilized after lapse of 03 years of the period of the Project. The possibility of use of balance amount of the Loan during the rest of 01 year period of the Project is remained doubtful.

3.2 Physical Progress

According to the information received, the physical progress as at 31 December 2014 on rehabilitation works of 06 national roads carried out by the Project is given below.

<u>Road</u>	<u>Road Length</u> Kilometres	<u>Physical Progress as at 31 December 2014</u> %
Matara – Godagama	3.40	100.00
Hikkaduwa- Southern Highway	14.34	62.34
Aluthgama- Southern Highway	11.07	69.05
Katururnda- Nagoda	2.72	100.00
Kirulapana- Godagama	13.3	57.81
Pamankada- Kesbewa	12.76	58.2

Total	57.59	
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The following observations are made.

- (a) The rehabilitation works of Kirulapana- Godagama Road which was expected to be commenced in 2013 had been delayed up to 2014 due to late mobilizing of required machinery, other equipment and man power etc. Further, a revised program had not been submitted by the contractor to match the actual scope of work and which may result of extension of time and cost overrun of the contract.
- (b) Even though the contract agreement for rehabilitation of works of the Pamankada– Kesbewa Road had been signed on 01 October 2012, the site for the construction of the Phase 01 of the Road had been handed over to the contractor on 25 March 2013 after delay of 06 months. Further, the possession of site for Phase 02 of the Road had been handed over to the contractor on 20 May 2014, after delay of another two months. Further, construction contracts had been awarded by the Project before completing of land acquisitions and shifting of utilities of the road and as a result, the contractor had failed to commence work according to the work programme.

3.3 Contract Administration

The following observations are made.

- (a) The quantities of the works of the rehabilitation of Matara – Godagama Road had been changed significantly and as a result, the cost of the works had been increased by Rs. 14 million. Further, construction of boundary wall at Rahula College at Matara at a cost of 14 million and relocation of pipe lines for water

system at a cost of Rs.25 million carried out by the Project were not included in the scope of the works.

- (b) The following observations are made on rehabilitation of works of the Pamankada– Kesbewa Road.
- (i) Even though the Engineer’s estimates for lump sum payments on preliminaries and general items amounted to Rs.145.33 million, the contractor had quoted a sum of Rs.256 million for such items. However, rate analysis had not been carried out before approving the estimates of the contractor.
- (ii) According to the Public Finance Circular No. 2/2012 of 07 August 2012, estimates for all procurements should be made by considering all the matters to ensure the accuracy of the total cost of the procurement. However, rehabilitation works of two sections of Pamankada - Kesbewa Road at an estimated cost of Rs.660.9 million and the construction at a bridge at Pamankada at an estimated cost of Rs.95 million had been withdrawn from the initial estimates and new bridge at Rattanapitiya had been introduced without ascertaining the costs thereon. Further, approval from the Cabinet Appointed Tender Board had not been obtained for such scope variations.
- (iii) According to the Paragraph 14.6 of the Special Conditions of the Contract, minimum value for the submission of interim payments was limited to Rs.66.4 million. However, interim payments aggregating Rs.487 million had been made on 12 occasions, out of 22 occasions made during the year under review without reaching up to the required minimum limit.
- (d) A sum of Rs.74.82 million had been spent for works carried out under the improvement of Hikkaduwa – Southern Highway Road such as providing facilities for Engineers, shifting of pipe lines belongs to the National Water Supply and Drainage Board, and development of infrastructure facilities to be carried out by the Local Authorities were not related to the activities at the Project.

In addition, a sum of Rs.5.74 million had been spent for construction of a building for the Office of Executive Engineers of the Road Development Authority and boundary walls at Hikkaduwa Post Office and Gonapinuwala Post Office were not related to the activities of the Project.

3.4 Matters in Contentious Nature

The following observations are made.

- (i) Although the local consultants are not entitled to any allowances other than their remunerations as per the Letter of Appointments, the fuel allowances and travelling expenses amounting to Rs.2.88 million and Rs.1.42 million respectively had been paid them during the year under review by the Project.
- (ii) According to the Bill of Quantities prepared for rehabilitation of Matara – Godagama Road 8,470 liner metres of pin curbs are required to be installed. It was observed that 2,198 liner metres of pin curbs had been installed and a sum of Rs 5.49 million had been paid at rate of Rs 2,500 per liner metre. However, balance of 6,272 liner metre of pin curbs had been installed subsequently and a sum of Rs 23.49 million had been paid thereon at a rate of Rs.3,745 per liner through 02 variation orders.
- (iii) Fuel cost amounting to Rs.2.35 million had been incurred by the Project for a motor vehicle which was not used for activities of the Project.
- (iv) Eventhough the residential facilities for the staff of the Implementing Agency are not expected to be provided by the contractor, a residence had been provided at a rent of Rs.4.64 million to the Engineers of the Road Development Authority.
- (v) According to the information received, out of the owners of 1,338 plots of land were qualified for compensation of the land acquired for the rehabilitation of Kesbawa –Pamankada Road, a sum of Rs.1,736.7 million had been paid up to 31 December 2014 to the land owners for 1,257 plots of land acquired. Further, a sum of Rs.2.6 million had been included therein as interest on delays in settlement compensation.