

## **National Highways Sector Project - 2014**

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The audit of financial statements of the National Highways Sector Project 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 34 of Schedule 6 of the Loan Agreement No. 2217 SRI dated 14 December 2006 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 Ports and Shipping, presently the Ministry of Highways and Investment Promotion and the Road Development Authority are the Executing and Implementing Agencies of the Project. The objectives of the Project are to improve the National Highways Network efficiency and strengthen Road Sector Institutions. As per the Loan Agreement, the estimated total cost of the Project was US\$ 216 million equivalent to Rs. 23,760 million and out of that, US\$ 150 million equivalent to Rs.16,500 million was agreed to be financed by the Asian Development Bank. A Memorandum of Understanding was signed by Government of Sri Lanka with Asian Development Bank on 15 February 2008 and Loan Agreement had been amended accordingly on 27 May 2008 to change the scope of the Project within the original Loan amount. In addition to the above, another Loan Agreement No. 1355P had been signed by the Government of Sri Lanka with OPEC Fund for Economic Development on 04 October 2010 and agreed to be allocated US\$ 8 million equivalent to Rs. 880 million by the OPEC Fund for Economic Development. A Supplementary Loan Agreement No. 2767 –SRI had also been signed by the Government of Sri Lanka with Asian Development Bank on 04 October 2011 to allocate US \$ 85 million equivalent to Rs. 9,350 million. The financial statements for the year ended 31 December 2014 for allocations made under the Supplementary Loan Agreement had been furnished separately. As per the initial Loan Agreement, the Project activities had been commenced on 07 April 2006 and scheduled to be completed by 31 December 2012. However, the activities of the Project had been continued upto 31 December 2014 using contribution of the Government of Sri Lanka. The financing activities of OPEC Fund for Economic Development will be closed on 30 June 2015. The activities carried out under the Supplementary Loan Agreement were scheduled to be completed by 30 June 2016.

### **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 judgement, 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 with.

### **1.5 Basis for Qualified Audit Opinion**

My opinion is qualified based on the matters described in paragraph 2.2 of this report

## **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, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report. 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 Accounting Deficiency**

The provision for depreciation as at 31 December 2014 had been overstated by Rs.169,312 due to erroneous calculations.

### **3. Financial and Physical Performance**

#### **3.1.1 Utilization of Funds**

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

Source	Amount agreed for financing in the Loan Agreement		Funds utilized during the year 2014		Funds utilized up to 31 December 2014	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
ADB	150.00	16,500.00	-	-	150.00	17,272.20
OFID	8.00	880.00	-	-	8.00	928.55
GOSL	58.00	6,380.00	7.73	1,004.57	62.51	8,125.74
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	216.00	23,760.00	7.73	1,004.57	220.51	26,326.49
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#### **3.2 Physical Progress**

According to the Implementation Plan of the Project, the activities of a rehabilitation works of 06 national roads and construction of the Highway Secretariat Building were expected to be carried out by the Project. According to the information received, all the road rehabilitation works carried out by the Project had been completed as at 31 December 2014. However, the constructions works of State III of the Building had not been completed as at 31 December 2014 eventhough it was expected to be completed by 30 July 2014.

#### **3.3 Contract Administration**

The contract for the construction of the Highways Secretariat Building had been awarded to a private party at an estimated cost of Rs. 599.30 million on 17 August 2010 and first 03 levels, out of all 08 levels of the Building was expected to be completed before 04 November 2011. However, at the time of 90 per cent of the works completed, the Project Monitoring Unit had awarded the contract for construction of other five levels to the same contractor at an additional cost of Rs.568.14 million in December 2011 and treated it as a variation of the contract. Further, the Project Monitoring Unit had decided in June 2012 to extend the Building for further two levels at an estimated cost of Rs.795.73 million. Therefore, the total anticipated cost of the Building comprised with all ten levels was Rs.1,963.17 million as at 31 December 2014. The approval of the Cabinet of Ministers for the above mentioned 03 stages had been obtained on 11 July 2013 and to incur the additional costs from the contribution of Government of Sri Lanka. Following observations are made in this regard.

- (i) Eventhough it was mentioned in the progress report of the Consultant for the month of February 2013 that the works of all ten levels of the Building was substantially completed, the approvals from Technical Evaluation Committee had not been obtained for the scope variations and time extensions granted thereon according to the paragraphs 4.3.2 and 8.13.4 of the Government Procurement Guidelines. Further, the contractor had mutually agreed with the Project Monitoring Unit to continue the construction of works of later stages and no written agreement or Memorandum of Understanding had been signed thereon.
- (ii) As a result of regular changes made in the scope of the construction works, the contractor was allowed rooms to apply higher rates for the variations of the works. Thus evidenced that the variations of the cost ranging from 13 per cent to 68 per cent over the estimated costs on additional works carried out under Stage III of the construction. The revised programmes had not been updated and submitted by the contractor and as a result, liquidation damages could not be determined and recovered from the contractor.
- (iii) According to the Building Plan, no premises had been reserved for car parking purposes within the Building or outside. Therefore, an additional location needs to be provided thereon.
- (iv) According to the Specific Condition of the Contract Agreement, the contractor had allowed to claim 15 per cent profit margin on additional or extra works. However, instances were observed that 25 per cent of profit margin had been claimed, contrary to the above Condition. Further, according to the Letter No C/369/10/HSB-HO/2013 of 17 November 2012 of the contractor, it was agreed that not to furnish any additional claims over the amount agreed for Stage III of the construction. However, it was observed that an additional claim aggregating Rs.6.14 million had been made on retaining of workers, material at sites and transport charges etc.,
- (v) According to the Clause No.14.10 of the Contract Agreement, contractor is required to submit a Statement of Completion at the end of the contract to confirm that all works included under the Bill of Quantity was completed. However, the contractor had submitted the Statement of Completion for works valued at Rs.50.13 million which were not completed even as at 31 December 2014.

### **3.4 Matter in Contentious Nature**

A Consultant had been appointed initially for interior designing for the Highway Secretariat Building and paid a sum of Rs.37.77 million as at 31 August 2014. However, another Consultant had been appointed on 22 September 2014 without

applying procurement procedure for the purpose of interior designing of the Level 09 of the Building at an estimated cost of Rs 7.19 million.

### **3.5 Issues on Financial Controls**

The following observations are made.

- (a) The contractor engaged in the construction of Highway Secretariat Building had been paid a sum of Rs.32.25 million for supplying and installation of metal ceiling under a variation order made in September 2014 and later, it was revealed that a sum of Rs.2.57 million had been over paid thereon. The Project had taken action to recover the overpayments in December 2014 allowing additional financial benefits to the contractor. Further, horizontal cable tray valued to Rs.8.14 million had been supplied and installed and the contractor had been paid a sum of Rs.11.63 million thus showing an over payment of Rs.3.49 million. However, this over payment had also been recovered in December 2014, after 08 months from the date of payment.
- (b) The Project had allowed to supply and install various items of accessories for the Secretariat Building such as a generator, street lighting system, air conditioning system, elevators and other items etc, at a cost of Rs.268.79 million and treated as variations to the main contract, allowing the contractor to earn additional gains such as 15 per cent of profit and overhead charges and another 15 per cent of fixing charges etc.

### **3.6 Human Resources Management**

The following observations are made.

- (a) The cadre of the Project had comprised with 70 employees at the end of the year under review, eventhough 59 cadre positions had only been approved by the Department of Management Services. However, 11 vacancies including 03 Senior Engineers were remained unfilled at the end of the year under review. Further, 08 Consultants and 02 Clerks and a System Analyst had been deployed and paid Rs.3,158,130 by the Project during the year under review eventhough such posts were not approved by the Department of Management Services.
- (b) According to the Paragraph 2.2.7 of the Circular No.33 dated 05 April 2007, all appointments of the Project should be made on contract basis for a maximum period of three years renewable annually subject to satisfactory performance. However, 34 staff members of the Road Development Authority had been employed by the Project on temporary basis, contrary to the above requirement.