

Northern Road Connectivity Project (NRCP) Original Scope and Additional Financing - 2014

The audit of financial statements of the Northern Road Connectivity 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 4.05 of Article IV of the Loan Agreement No.2639-SRI dated 27 August 2010 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 Ports and Highways, presently the Ministry of Highways and Investment Promotion is the Executive Agency and the Road Development Authority is the Implementing Agency of the Project. The Road Development Authority is responsible for the management and coordination of Project activities at the National level. The objective of the Project is to rehabilitate and improve the 170 kilometres of national roads in the Northern and North Central Provinces. The initial estimated total cost of the Project is US\$ 146 million equivalent to Rs.18,980 million and out of that US\$.130 million equivalent to Rs.14,950 million was agreed to be financed by the Asian Development Bank. Further, the Asian Development Bank had allocated additional financing of US\$.68.34 million equivalent to Rs.8,840 million under the Loan No. 2890 SRI(SF) of 31 May 2013 and US\$ 30 million equivalent to Rs.3,900 million under the Loan No.2891 SRI of 31 May 2013 to rehabilitate approximately 288 kilometres of national roads highways in the Northern and North Central Provinces. The Project commenced its activities under the initial Loan Agreement on 22 October 2010 and scheduled to be completed by 31 December 2015. The activities of the Project under additional financing arrangements had been commenced on 13 May 2013 and scheduled to be completed by 30 June 2018.

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 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 Agreements,
- (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 were observed.

- (a) It was observed that bonus and medical allowance Rs. 745,390 had been paid to the employees of the Road Development Authority attached to the Project, contrary to the Sections 8.3.9 and 8.6 of the Circular No PED/12 dated 02 June 2003 of the Department of Public Enterprises.
- (b) Salaries amounting to Rs.24,129,037 of the employees of the Road Development Authority attached to the Project had been paid during the year under review based on the formula introduced by the Road Development Authority, contrary to the Circular No.33 of 05 April 2007 of the Department of Management Services..
- (c) Although the Ministry of Finance and Planning had approved to grant exemption on payment of taxes for Northern Road Connectivity Project, Value Added Tax amounting to Rs.512,648 had been paid by the Project during the year under review, contrary to the instruction given in Section 8.3.9 of the Circular No. PED/12 dated 02 June 2003 issued by the Department of Public Enterprises of the General Treasury.
- (d) As specified in Section 5.4.4 of the Contract Procurement Guidelines, mobilization advance for any contract work should be paid on contract amount excluding provisional sum and contingencies. However, mobilization advances amounting Rs.3,811 million that had been calculated including provisional sum and contingencies in contrary to the above instructions.

3. Financial and Physical Performance

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	Amounts agreed for financing in the loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilization</u>		
	US\$ million	Rs million	Rs million	during the year 2014	Up to 31 December 2014	
				Rs million	US\$ million	Rs million
Loan 2639-SRI	130	14,950	2,536.00	2,866.40	112.37	14,609
Loan 2890 SRI(SF)	68	8,840	2,438.00	1,358.30	13.03	1,694
Loan 2891-SRI	30	3,900	-	1,257.30	11.46	1,490
GOSL	-	2,080	18.32	41.14	0.33	44
	<u>228</u>	<u>29,770</u>	<u>4,992.32</u>	<u>5,523.14</u>	<u>137.19</u>	<u>17,837</u>

According to the above mentioned information, 60 per cent of proceeds of Loan allocated had been utilized during the period of 1 ½ years of operations of the Project.

3.2 Physical Progress

The activities of the Project had comprised with 02 components which rehabilitation works to be done under original scope of works and additional funding arrangements. According to the Project Implementation Plan for original scope of works, 10 national roads in the Northern and North Central Provinces with the length of 170 kilometres were expected to be completed. The Project had awarded 10 contract packages for rehabilitation of such roads and all the rehabilitation works had been substantially completed as at 21 December 2013. Under the Stage 11 of the contracts the contractors were committed to enter into performance based road maintenance contracts and carry out road maintenance works of such roads for further 03 years.

Further, the contracts for rehabilitation works of other 10 roads in Northern and North Central Provinces had been offered in 2013 and 2014 under the additional financing arrangements and the physical progress ranging from 30 per cent to 75 per cent had remained as at 31 December 2014. Out of that the rehabilitation works of Jaffna-Pannai-Kayts Road commenced in December 2013 had shown slow physical progress of 30.7 per cent as at 31 December 2014.

3.3 Contract Administration

- (a) The following observations are made on the contracts awarded under the original scope of the Project.
- (i) According to the mission reports, the recommendations issued to widen road shoulders and construction of retaining walls at several locations of the Valai-Araly Road had not been implemented by the Project.
 - (ii) Criteria had not been established to determinate service levels of the works carried out under performance based road maintenance works and assess the monthly performance to make payments according to the performance indicators. Further, the contractors had not submitted a Method Statement for performance based maintenance activities. Further, the separate contract agreements for performance based maintenance works had not been entered into with the contractors and as a result, the possibility of arising of disputes on settlements of claims cannot be ruled out in audit.
 - (iii) The defect liability period of the rehabilitation works Mankulam- Mulative Road carried out at a cost of Rs. 3,181,443 had been completed in July 2014. However, the rectification of the defects in 11 locations between section 18+446 kilometre to 20+720 kilometre of the Road highlighted in the Non-Conformity Reports had not been carried out even as at 31 December 2014.
- (b) The following observations are made on the contracts awarded under the additional funding arrangement of the Project.
- (i) It was observed that the cost of over time amounting to Rs.86,810 of the technical staff of the Consultant had been incurred by a contractor eventhough the staff of the Consultant is not allowed to receive any financial or other benefits from the contractor, according to the provisions made in the consultancy service agreement.
 - (ii) It was observed in several instances that the financial and physical resources of the contractors were not effectively utilized for the purpose of the activities of the contract, causing risks on completion of the contracts during the agreed timeline. The human resources including an Quality Control Manager and labourers were not adequately employed for the rehabilitation works of the Jaffna-Pannai-Kayts Road by the contractor.
 - (iii) According to the paragraph 103.4 of Volume 3-technical specification, the contractor should comply with safety precautions and satisfactory traffic controlling arrangements and that should be continued during the execution of work. The progress reports and site meeting minutes

shows severe safety violation at the reconstruction of Medawachchiya-Kebithigollawa Road due to lack of barriers around deep excavation sites, road signs at places where narrowing the road etc.,.

- (iv) Although Non Conforming Product Notifications were issued for the defective locations of the Kebithigollawa – Padaviya Road, either the plans for required corrective action had been submitted by the contractor for the Engineer’s approval or action to rectify the asphalt failed sections of the Road.
- (v) Eventhough the Environmental Monitoring Reports are submitted by each contractor according to the Clause 4.18 Special Condition of the contract in every month, several instances were observed that the environmental compliances procedures had not been adopted by the contractors. At the physical audit tests carried out in May 2015 debris and excavated material were found along the Medawachchiya-Kebithigollawa Road and measures had not been taken to control dust emission of the crusher plant and asphalt plant located at Ethakada.
- (vi) The Project had undertaken to supply pipe and fittings, excavation, back filling and pipe laying activities on behalf of the National Water Supply and Drainage Board for the reconstruction works carried out on Madawachchiya-Mannar Road and Jaffna-Pannai-Kayts Road and incurred costs of Rs.15.9 million and Rs.16.8 million respectively. However, the pipes and fittings valued at Rs.3.8 million had remained idle at Executive Engineer Office of the Road Development Authority at Maradankadawela without utilizing for intended purpose.
- (vii) The Project had released a sum of Rs.8.19 million to the Divisional Secretariat at Kayts at the end of the year under review for the payment of compensation on land acquisitions for rehabilitation of Jaffna-Pannai-Kayts Road. However, the details of payment such as list of owners, acknowledgements received from them had not been presented for audit. Further, the unspent sum of Rs.1.32 million had been transferred to a deposit accounts by the Divisional Secretariat at the end of the year under review. Further, it was observed that the Project had released a sum of Rs. 2.79 million to the Divisional Secretariat without identifying the land owners of 76 plots of land.

3.3 Matters in Contentious Nature

The following observations are made.

- (a) The contract for rehabilitation of Vallai to Araly Road from 0+000 kilometre to 27+400 kilometre had been awarded in May 2011 and the rehabilitation works of the road section from 4+140 kilometre to 9+200 kilometre had been withdrawn subsequently due to security reasons. However, the contractor had transported the entire soil requirements for the rehabilitation works from Kilinochchi area without a prior approval. As a result, the dispute between the Project and the contractor arisen had been settled with the agreement to pay a sum of Rs.91.20 million to the contractor and a sum of Rs. 1.62 million to the arbitrators.
- (b) In addition to the above another dispute had been arisen on the contract for rehabilitation of Thonigala to Galkulama Road awarded on 10 May 2011 on increase of rates indicated in the Bill of Quantity for Dense Graded Aggregate Base Course by 115 per cent. Therefore, the Project had paid a sum of Rs.25.70 million additionally to the contractor based on the settlement arrived in December 2013. However, it was later revealed that the respective dispute had arisen due to incomplete Bill of Quantity prepared by the Design Consultant and no action had been taken against the responsible parties,