TRINCOMALEE INTEGRATED INFRASTRUCTURE PROJECT (TIIP) – COMPONENT– 01 (NATIONAL HIGHWAYS) - 2013

The audit of financial statements of the Trincomalee Integrated Infrastructure Project (TIIP) – Component – 01 (National Highways) for the year ended 31 December 2013 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 4.01 (b) (i) of Article IV of the Development Credit Agreement No. 3000 01 H dated 05 October 2005 as amended by Agreement dated 11 April 2008 entered into between the Government of the Democratic Socialist Republic of Sri Lanka (GOSL) and the French Development Agency (AFD).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Credit Agreements of the Trincomalee Integrated Infrastructure Project (TIIP), then Ministry of Highways, Ports and Shipping and presently, Ministry of Highways, Higher Education and Investment Promotions is the Executing Agency of the Project and the Road Development Authority is the Implementing Agency. The objective of the Project is to rehabilitate 98 kilometres of the A 15 Road, 41 kilometres of B10 Road and 12 kilometres of other coastal roads. According to the Credit Agreements, the estimated total cost of the Component I of the Project is EURO 76.2 million and out of that EURO 58.16 million or 76.30 per cent was agreed to be financed by the French Development Agency. The Project commenced its activities in May 2006 and was scheduled to be completed by 30 May 2011. Subsequently the Project period was extended up to 31 December 2012.

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 Generally Accepted Accounting Principles. This responsibility includes; designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

2. Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on a review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore, believe that my audit provides a reasonable basis for my opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

(a) Whether the systems and controls were adequate from the point of view of internal controls 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 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 identification of the purchases made out of the Loan, etc.,

(c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Credit Agreements,

(d) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project,

(e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,

(f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles,

(g) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(h) Whether financial covenants laid down in the Credit Agreements had been complied with.

3. 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 the paragraph 5 of this report, I am of opinion that,

(a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted Accounting Principles,

(b) the funds provided had been utilized for the purposes for which they were provided,

(c) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(d) the financial covenants laid down in the Credit Agreements had been complied with.

4. Financial Statements

4.1 Financial Performance

According to the financial statements and information made available for audit, the Project expenditure for the year under review amounted to Rs.35,082,970 and the cumulative expenditure as at 31 December 2013 amounted to Rs.11,536,831,720. A summary of the Project expenditure for the year under review and the preceding year and the cumulative expenditure as at 31 December 2013 is given below.

Item	Expenditure for the year ended 31 December		Cumulative Expenditure as at 31 December 2013
	2013	2012	
	Rs.	Rs.	Rs.
Civil Works	23,032,585	778,368,517	10,798,414,137
Work-in- Progress	12,050,385	-	738,417,583
	35,082,970	778,368,517	11,536,831,720

5. Audit Observations

5.1 Accounting Deficiencies

Contingent liability on arbitration case filed by a Contractor by claiming a sum of Rs.2,965,427,287 from the Project had not been disclosed in the financial statements.

6. Financial and Physical Performance

6.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provisions for the year under review, utilization of funds during the year under review and the cumulative expenditure as at 31 December 2013 are shown below.

Source	Amount agreed to be financed		Allocation made in the Annual Budget	Amount utilized during the year under review		Amount utilized as at 31 December 2013	
	Euro Mn.	Rs Mn.	Rs Mn.	Euro Mn.	Rs Mn.	Euro Mn.	Rs Mn.
AFD	58.16	9,340	300	-	-	57.59	8,828
GOSL	18.04	2,897	185	0.43	70	15.23	2,446
Total	76.20	12,237	485	0.43	70*	72.82	11,274*

* These figures do not agree with figures shown in the paragraph 4.1 of this report as payables as at end of the year are not included.

6.2 Physical Performance

6.2.1 Rehabilitation Works of A 15 Road

The following observations are made.

(a) According to the investigation report submitted by the Department of Civil Engineering of the University of Moratuwa on the request made by the contractor, it was revealed that the designs for T5 or T6 traffic category were more suitable for the rehabilitation of A 15 Road. However, a design of T3 traffic category had been adopted by the Project for rehabilitation of the Road.

(b) According to Clause 11.1 of Volume 2 of the Contract Agreement entered into between the Road Development Authority and the China Harbor Engineering Company Ltd., the contractor should execute all remedial works on defects or damages caused to the road at the cost of the contractor. However, sums aggregating Rs.656 million had been paid to the contractor up to the end of the year under review from the proceeds of the Project for rectification of defects. Further, severe damage on the surface of the Road had been rectified by re- laying asphalt by the Project at a cost of Rs.121,876,240.

(c) The audit inspections carried out on various occasions in the year 2014 revealed that there were quality failures at 2,854 locations of the Road. It indicated that the services of two testing laboratories established by the Project at a cost of Rs 52 million had not been effectively used by the contractor for the purposes of quality assurance of the Road. Further, according to Sub- clause 11.8 of the Contract Agreement, the contractor is responsible to undertake the tests at damaged locations to determine to causes for defects. Therefore, the contractor had taken action to obtain the service from the University of Moratuwa to investigate the damaged locations under the directions of the Engineers of the Project. But the reasons for quality failures had not been mentioned specifically in their reports.

(d) According to the laboratory reports obtained directly by the auditors, it was revealed that soil obtained from two borrow pits and used for land filling at the locations from 50 kilometre to 90 kilometre of the Road was not suitable for land filling purposes.

(e) According to the initial plan 185.5 kilometres of the Road was expected to be rehabilitated. However, a distance of 34 kilometres of the Road had not been rehabilitated by the Project due to lack of funds. Out of that, a distance of 22 kilometres of the Road had been rehabilitated by the Department of Provincial Road Development of the Eastern Provincial Council. Eventhough a sum of Rs.7,627,000 had been spent by the Project for surveying of 34 kilometres of the Road such plans had not been used by the Department of Provincial Road Development for rehabilitation purposes. Therefore the cost incurred for surveying purposes had become fruitless.

(f) Eventhough the activities of the Project had been closed down on 31 August 2012 action had not been taken by the Contractor to handover the Road to the Road Development Authority and submit final bills to the Project even as at 30 September 2014.

6.2.2 Construction of Bridges

According to item No.1011.4 (6) of the Bill of Quantities, a sum of Rs.1,223.85 million had been allocated to construct 300 pile foundation for 05 bridges. As stated in the progress reports, 134 file foundations had only been carried out for 05 bridges and a sum of Rs.3,150.72 million had been spent thereon. However, the approvals from the relevant parties for such major variations of the design had not been obtained.

6.3 Assets Management

The following observations are made.

(a) It was observed that 502 items of furniture and equipment valued at Rs.3,616,319 which were allowed for use by the Contractor of the Project had not been returned back to the Road Development Authority even at the completion of the activities of the Project. The Secretary of the Ministry of Highways, Ports and Shipping informed me on 02 January 2014 that action will be taken to recover a sum of Rs.838,711 from the Contractor for those items .

(b) The Project had spent a sum of Rs.30,500,000 to construct 10 temporary buildings for site offices and accommodation purposes. However, it was revealed that materials removed from those buildings after completion of the activities of the Project had not been handed over to the Road Development Authority.

(c) According to the information obtained for audit, the Project had refused to grant extension for the period of Consultancy Services, beyond 31 October 2012. However, the Project had not obtained the Project Completion Report and Project Review Report up to date from the Consultants in terms of Paragraph VII of terms of the consultancy agreement.

6.4 Extraneous Transaction

(a) According to the Letter No.13/959 dated 29 August 2011 issued by the Deputy Commissioner, International Unit of the Department of Inland Revenue, income tax on profit earned by the Contractor should be recovered by the Project and remitted to the Department of Inland Revenue. However, the Project had paid the income tax amounting to Rs. 23,242,622 on behalf of the contractor from the Project funds without taking action to recover from the contractor.

(b) According to the Inland Revenue Act, No.38 of 2000 and the Public Finance Circular No.PF/PE/06 dated 31 January 2000, Pay As You Earn Tax should be borne by the employee. However, the Project had paid Pay As You Earn Tax amounting to Rs.24,720,884 out of the Project funds based on the total salaries paid to the Consultant instead of being recovered from his salary.

7. Systems and Controls

Special attention is needed in respect of the following areas of control.

(a) Accounting
(b) Civil Works
(c) Consultancy Services
(d) Inventory Control