

Road Sector Assistance Project - 2012

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 adjustment arising from the matters referred to in paragraph 3 of this report, I am of opinion that;

- (a) the Project had maintained proper accounting records for the year ended 31 December 2012 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2012 in accordance with Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the withdrawals from and replenishments to the Special (Dollar) Accounts during the year ended 31 December 2012 had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2012 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) 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 Development Credit Agreements.
- (e) satisfactory measures had been taken by the management to rectify the issues highlighted in by previous year audit report, and
- (f) the financial covenants laid down in the Development Credit Agreements had been complied with.

2. Financial Statements

2.1 Financial Performance

According to the financial statements and information made available, the expenditure of the Project for the year under review amounted to Rs. 3,527,986,832 and the cumulative expenditure as at 31 December 2012 amounted to Rs. 27,176,611,394. The following statement shows a summary of the expenditure for the year under review and the preceding year and the cumulative expenditure as at 31 December 2012.

<u>Description</u>	<u>Expenditure for the year ended 31 December</u>		<u>Cumulative expenditure as at 31 December 2012</u>
	<u>2012</u>	<u>2011</u>	
	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>
Fixed Assets at cost	37,382,303	36,527,877	218,715,595
Civil Works	-	689,957,862	22,790,061,873
Civil Work-in-Progress	2,935,852,461	72,209,034	3,008,061,495
Design Consultancy	-	-	122,604,637
Project and other Consultancy	18,616,519	34,955,627	105,229,507
Construction Supervision	17,215,520		17,215,520
Project Expenses	161,978,285	96,986,530	506,206,542
Training	17,478,446	5,411,577	67,125,528
Relocation of Utilities	7,084,035	-	315,357,855
Net Current Assets	332,379,263	(315,223,518)	26,032,842
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	3,527,986,832	620,824,989	27,176,611,394
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2.2 Special (Dollar) Accounts

According to the financial statements and information made available, three Special (Dollar) Accounts had been maintained at the CBSL during the year under review for all three Agreements. A summary of the operations and the balances of respective accounts as at 31 December 2012 are given below.

Loan No	4429CE		4138CE		4906CE	
	SLRs	USD	SLRs	USD	SLRs	USD
Balance as at						
01 January 2012	117,823,746	1,034,437	96,698,959	848,972	10,010,654	87,889
Add :						
Replenishments	2,993,883,928	24,409,907	97,393,373	848,875	151,066,301	1,161,232
Foreign Exchange Gain/ (Loss)	165,541,956	-	21,371,352	-	(263,112)	
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	3,277,249,630	25,444,344	215,463,684	1,697,847	160,813,843	1,249,121
<u>Less</u>						
Withdrawals	2,118,324,092	16,330,485	144,155,992	1,137,079	112,849,445	871,926
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Balance as at						
31 December 2012	1,158,925,538	9,113,859	71,307,692	560,768	47,964,398	377,195
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3. Comments on Financial Statements

3.1 Accounting Deficiencies

Following observations are made.

- (a) The total value of work done on rehabilitation of nine roads under first Development Credit Agreement aggregating Rs.15,227 million had been reduced upto Rs. 14,994 million under the recommendations of the Cabinet Appointed Procurement Committee granted on 28 November 2012 to revise the contract values of such roads and shown under civil works and

construction supervision of the financial statement as at 31 December 2012 without notifying it to the contractors. Further, confirmation had been called for from 5 contractors who carried out rehabilitation works under the respective contracts, only one contractor had confirmed balances aggregating to Rs 22.15 million relating to two contracts, as receivable. According to the financial statements, a sum of Rs.3.49 million had remained payable to him as at 31 December 2012.

- (b) The import cost and bank charges aggregating Rs.5.3 million incurred to procure a Road Milling Machine had been shown as the cost of the asset in the Statement of Financial Position as at 31 December 2012 eventhough the respective machine had been physically received to the Project Management Unit (PMU) only on 05 February 2013.
- (c) Depreciation on Multi- functioned survey vehicle aggregating Rs.6.9 million had been under provided for the period from 2010 to 2012, as a result of errors in recognizing value of the Property at initial stage .
- (d) A sum of Rs.5 million payable to a private company as at 31 December 2012 for the procurement of a tool kit and data processing unit for the Multi-functioned survey vehicle had not been brought to account.

3.2 Un reconciled Balances

Following observations are made.

- (a) The cost of 15 items of Property , Plant and Equipments aggregating Rs.85.1 million shown in the statement of the financial position as at 31 December 2012 was not agreed with the cost of such assets aggregating Rs.84.5 million shown in the fixed assets register maintained by the PMU. Therefore, it was evident that the items and values of such assets had not been properly identified and recorded by the Project at the time of supplying such assets.
- (b) Credit balance amounting to Rs. 679,727 had been shown under Tsunami Emergency Recovery Project - Current Account in the Statement of Financial Position since 2009 without taking action to reconcile and settle it.

5. Physical Performance

5.1 Utilization of Funds

According to the financial statements and information made available, certain significant statistics relating to the financing of the Project, budgetary provisions and the utilization of funds up to the end of the year under review are shown below.

<u>Financing Plan</u>	<u>Amount allocated under foreign components</u>		<u>Provisions made in the Annual Estimate for the year under review</u>	<u>Funds utilized</u>			
				During the year under review		Up to 31 December 2012	
	<u>USD</u>	<u>Rs.</u>	<u>Rs.</u>	<u>USD</u>	<u>Rs.</u>	<u>US</u>	<u>Rs.</u>
	<u>Mn</u>	<u>Mn</u>	<u>Mn</u>	<u>Mn</u>	<u>Mn</u>	<u>D</u>	<u>Mn</u>
						<u>Mn</u>	
IDA Development Loan Nos.							
4138CE	100.0	10,125	} 3,795.0	0.8	91	87.6	9,522
4429CE	98.1	11,579		24.4	2,994	92.3	10,775
4906CE	100.0	11,081		1.2	139	1.4	171
Exchange Difference					187		259
GOSL			121.5		117		6,449
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Total	298.1	32,785	3,916.5	26.4	3,528	181.3	27,176
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5.2 Road Rehabilitation and Reconstruction Works carried out under Phase- 01 of the Project

The Project had planned to carry out the rehabilitation and reconstruction works of 13 roads. According to the progress reports, rehabilitation and reconstruction works of all such roads had been substantially completed as at 31 December 2011 excluding Galkulama-Rambewa Road situated in North Central Province of which improvement works abandoned subsequently. Following matters were revealed in audit on rehabilitation and reconstruction works of the roads.

- (a) The initial estimated cost of the contracts for improvement works of 11 roads aggregating Rs.11,450.6 million (without VAT) had been subsequently increased upto Rs.19,193.4million (without VAT) representing 67.6% increase of initial estimates due to changes made in the original scope of the work and allowances made for the price fluctuations. However, the approval of the Cabinet of Ministers had been received to increase the cost of works of 09 roads by Rs. 266.7 million (without VAT) only representing 2.33% of initial estimated cost . Further, increases of initial estimated costs of two other roads namely Nittambuwa- Kandy Road and Galle- Deniyaya Road had not been approved by the Cabinet of Ministers even as at 31 December 2012.
- (b) It was observed that the rehabilitation works carried out in Nittambuwa-Kandy Road under Phase -01 of the Project was not in satisfactory level due to non- compliance with the technical standards. It was further revealed that such deficiencies were occurred as a result of negligence of the contractor and the consultant from the planning stage to completion of rehabilitation works. According to a report furnished in June 2010 by the University of Moratuwa relating to investigation of rehabilitation works carried out in Nittambuwa – Kandy Road, following deficiencies were observed.
- Lack of proper assessment carried out by the design consultants on the road surface and the transportation etc at the initial stages.
 - Deficiencies observed in mixing planning standards of road construction stages such as wearing course and binder course.
 - Cracks had developed on the road surface due to production of substandard asphalt, lack of compacting and insufficient tarring. No proper evidences were made available that the contractor had rectified the defects observed.

However, the Secretary to the Ministry of Ports and Highways had taken action to get the defect rectification works of the road from the contractor without incurring additional costs to the Project. Further, a Committee comprised with the officers of the Ministry of Ports and Highways, RDA and IDA and the representatives of the Contractor and the Consultant had been

appointed on 27 July 2010 to monitor the rectification works, examine the cause of defects, and inspect the site periodically and advise the field staff on improvement to the quality of the works. Initially, it was expected to complete the rectification works of the defects of the roads by 31 March 2012. Further, the WB mission visited in December 2012 had reported that the rectification works to be completed on or before 15 January 2013. However, the progress of the Slurry / Fog sealing activities from 40+550km to 59+908km of the road was only 86%, as at 31 December 2012 and continued such works up to 30 April 2013.

- (c) Further, penalties aggregating to Rs.12.34 million paid on delays of settling contractors' claims by the Project in connection with the rehabilitation of three roads namely, Haliela- Bandarawela road (CP-03), Bandarawela-Welimada road (CP-04) and Siyabalanduwa-Ampara- Karativu road (CP-10) had been included in the cost of civil works of the respective contract.

5.3 Road Rehabilitation and Reconstruction Works carried out under Phase 02 of the Project

5.3.1 Changes made in the scope of the works

According to the Schedule -01 of the Financing Agreement for second additional funding for the Road Sector Assistance Project (RSAP), SDR 63,600,000(USD 100,000,000) equivalent to Rs.114,000,000 had been allocated with the aim of rehabilitating priority roads in the East-West corridor providing connectivity to the Northern Province. Therefore, it was expected to rehabilitate two roads namely, A06 Ambepussa- Dambulla Road (91 km) with widening of the road from two lanes to four lanes and A06 Kantale –Trincomalee Road (43 km). However, it was subsequently decided to change the scope of the Project activities and rehabilitate the sections of A02 Colombo-Galle- Hambantota- Wellawaya Road from Maliban Junction to Panadura (17 km) and A03 Peliyagoda- Puttalam Road from Peliyagoda to Ja-Ela (28 km) instead of A06 Ambepussa- Dambulla Road. The approval of the World Bank had been received on 28 April 2012 for this purpose. Further, the PMU had taken action to rehabilitate 16.45km from Maliban Junction to Panadura Town with widening of the road from two lanes to six lanes and 17.50 km from Peliyagoda to Ja-Ela with widening of the road from four lanes to six lanes. Therefore, the Project had deviated from the primary objectives of rehabilitating priority roads in the East-West corridor and taken action to rehabilitate the 76.65km of Southern roads instead 91 km of connectivity roads to Northern Province.

5.3.2 The Rehabilitation and Improvement works of Kantale- Trincomalee Road

The rehabilitation and improvement works of the 42+300 km of A06 Kantale-Trincomalee Road (Section 157+000 km to 199+300 km) had been commenced in 2011 and completed in 2012. The total length of the road had been divided into four sections, invited bids under national complete bidding procedure and awarded the contracts to four contractors. Details of the rehabilitation works of the sections of the road are given below.

Section	Agreed value of the contract (without VAT)	Road Length	Cost per km	No Bridges to be constructed / rehabilitated	No. of culverts to be constructed/ to be rehabilitated
	----- Rs.	----- km	----- Rs.	-----	-----
Kantale – Ganthalawa (KT/01)	864,713,924	13.38	64,627,348	03	37
Gantalawa- Thampalagama (KT/02)	834,106,005	10.72	77,808,396	03	43
Thampalagama- Sardhapura (KT/03)	719,078,523	12.00	59,923,210	08	43
Sardhapura – Trincomalee (KT/04)	948,343,937	9.30	101,972,466	01	50

Following observations are made on the rehabilitation works of the road.

- (a) As appearing in the above table, the agreed cost per kilometer of the sections of the road was varied significantly. According to the explanations made by the Secretary to the Ministry of Ports and Highways, the cost per km in KT/04 was higher than other sections of the road due to the nature and complexity of work in that road section. In addition, the agreed value of the contracts had exceeded the Engineers' estimates for all sections of the road as a result of preparation of estimates using 2010 Highways Schedule of Rates (HSR) eventhough the bids had been called for in 2011.

According to the audit point of view, the contract prices of three sections, out of four sections of the road had been increased by over 20% significantly.

- (b) According to the contract agreements, the rehabilitation works were scheduled to be completed before end of October 2012. However, all four contracts had been completed with delays ranging from 02 to 04 months due to slow progress shown by the contractors on several works such as road excavations, site clearings, drainage works, construction of bridges and culverts and supply of road furniture, road marking etc. Further, the allowance for price escalation aggregating Rs.4.46 million had been made from Kantale to Gantalawa (KT/01) section of the road without considering the delays occurred due to failures of the contractors.
- (c) As specified in the Section 5.4.4 of the Government Procurement Guidelines and Paragraph 14.2 of Standard Bidding Document of the Institute of Contract Training and Development (ICTAD), advance payments for any contract for works should be paid excluding any provisional amounts and contingencies. However, advance payments on all four contracts aggregating Rs.504 million had been made on total contract amount of Rs.3,366 million which includes provisional and contingencies aggregating Rs.516.8 million. Therefore, advances aggregating Rs. 76.9 million had been overpaid.
- (d) According to the Clause No 14.6 of Section VIII of the condition of the contract agreements, minimum value of an Interim Payments Certificate (IPC) should be at least 2% of agreed value of the contract. However, seven IPCs had been raised and payments aggregating Rs. 77.87 million had been made to the contractors for the rehabilitation of road sections from Thampalagama to Sardhapura (KT/3) and from Sardhapura to Trincomalee (KT/04), before reaching minimum level of 2% of agreed value of the contract.
- (e) It was revealed in audit that the payments made to the contractor who carried out the rehabilitation works of the road section from Kantale to Gantalawa (KT/01) section was not complied with the standards stipulated by the ICTAD. Instances observed are described below.
 - (i) According to Paragraph 119.2 of the Standard Specification for Construction and Maintenance of Roads and Bridges (SCA/5) of the ICTAD, payments should be made to the contractor on submission of the original insurance, bonds guarantee or security. However, the invoices and bills in respect of the lump sum payment on insurance aggregating Rs. 20.83 million made directly to the contractor and the invoices and bills in respect of such payments had not been made available for audit.
 - (ii) It was observed that 1,104 square meter of Geo-textile purchased over the quantities required were remained at the site since May 2012 upto January

2013 and the payments amounting to Rs.1.97 million had been made for these additional material.

- (f) According to the IPC of the road section from Thambalagama- Sardhapura (KT/03), actual quantities of work done had significantly exceeded the estimated quantities included in the BOQ. Therefore, payments aggregating Rs.11.64 million had been made in excess of the estimate, thus indicating that BOQs had not been prepared realistically after making proper surveys.

5.4 Road Maintenance Trust Fund

Following observations are made.

- (a) The Road Maintenance Trust Fund (RMTF) had been established under the Deed of Trust signed by the Secretary to the Treasury on 09 December 2005. According to Section 06 of the Deed of Trust, revenue received consequent to the sale of petrol and diesel earmarked for road maintenance and proceeds received under the allocations made by the national budgets should be credited to the Trust Fund. Following observations are made in this connection.
 - (i) The Secretariat of RMTF carries out the functions of withdrawing the allocations made by the Annual Appropriation Act from the General Treasury and release such funds to the RDA for national road maintenance purposes. According to Section 06 of the Deed of Trust, the budgetary allocation including amount allocated from the revenue received consequent to the sale of petrol and diesel earmarked for road maintenance purpose and the budgetary allocation currently made to the MOPH for national road maintenance to be credited to the Trust Fund. However, action had not been still taken to stipulate a mechanism to collect the tax revenue from sale of petrol and diesel.
 - (ii) Further, a sum of Rs.1,332 million had been received to the Trust, out of the total allocation amounting to Rs.5,961 million made by the General Treasury for the road maintenance purposes in 2012. The balance amount of Rs.4,629 million had been received to the RDA through MOPH without a concurrence of the Trust.
 - (iii) Further, the RMTF had not taken action to prepare an Annual Action Plan for 2012 or Progress Reports at the end of the respective year as enable to measure the performance of the RMTF.
- (b) As mentioned in the audit report for the previous year, an agreement had been entered on 15 May 2008 to obtain the advisory services for establishment and management of RMTF at a cost of USD 631,750 equivalent to Rs. 68.3 million from foreign consultants and Rs. 31.10 million from local consultants. The period of the agreement had been expired in May 2011 and a sum of USD 291,411

equivalent to Rs.34 million for foreign consultants and Rs. 14.35 million for local consultants had been paid at the end of the said agreement. It was observed that several reports to be submitted during the year under review by the consultants such as the final reports on Technical Audit Manual, Report on Technical Audit Assistance and the Final Project Report for Stage -01 of the Project RSAP-01 had not been completed and furnished. Further, the Financial Manual which was prepared by incurring a sum of USD 63,175 equivalent to Rs.8.05 million and Rs.3.11 million and submitted by the consultant had not been made available for audit.

In addition to the above, a fresh agreement valued at USD 265,813 equivalent to Rs.31 million for foreign consultants and Rs. 14.94 million for local consultants had also been signed on 13 February 2012 with the same consultant without considering failure of submission of the reports mentioned above. It was expected to complete 13 other reports including outstanding deliverables under the first agreement. Eventhough, USD 119,615 equivalent to Rs.14 million for foreign consultants and Rs.6.95million for local consultants had been paid under new agreement, the progress of the submission of the reports thereon had remained behind the schedule.

5.5 Human Resources Management

As approved by the Department of Management Services, the staff of the PMU consists with 12 members of core staff and 20 members of supporting staff and the Project Consultancy Unit (PCU) located at Trincomalee consists with 17 members of core staff and 25 members of supporting staff. Following observations are made in this connection.

- (a) Four posts of Engineers had remained vacant whilst two clerks and a driver were recruited exceeding the approved cadre of the PMU as at 31 December 2012. Further, the PCU had been operated during the year under review with shortages of a contract specialist, a quantity Surveyor and 12 other members in supporting staff.
- (b) The staff of the PMU and PCU had comprised with the officers of the Road Development Authority who released on temporary basis by calling applications internally. As per paragraph 2.2.7 of the Circular No. MSD 33 dated 05 April 2007 of the Department of Management Services, staff of the PMU of foreign funded projects are required to recruit through public notices under contract basis for the maximum period of three years.
- (c) According to Paragraph 4.1.1 of the above Circular, officers who released in full time basis from the government agencies with no-pay leave and attached to a Project under contract basis are entitled for an additional allowance of 50% of the salary of the permanent post. However, allowances aggregating Rs. 4.83 million had been paid to 34 officers of the RDA who released temporally to the PMU and PCU.

- (d) As a practice, a provisional amount of gratuity of the staff of the RDA for the period of service at the PMU is remitted to the RDA by the Project. It was observed that the calculation of gratuity had been based on the entire period of service of the staff members instead of the period of service at the PMU. Therefore, an additional sum of Rs. 5.10 million had been remitted to the RDA up to 31 December 2012 for 22 officers of the RDA.

5.6 Contract Administration

Following observations are made.

- (a) It was observed that a sum of Rs. 2.4 million had been paid to the RDA, out of the provisions amounting to Rs. 2.5 million made for the construction of new building for RDA circuit bungalow at Trincomalee which was damaged due to improvements made at Kantale- Trincomalee road. The respective construction works had been carried out by the Eastern Provincial Director's Office of the RDA under direct labour basis. Further, the additional expenses on RDA overhead amounting to Rs.360,000 and profits amounting to Rs. 75,000 which costs to be charged from outside contractors under normal circumstances had also been included in the payments made in this connection and charged against the local contribution received for the Project.
- (b) The Project had entered into a contract agreement with a private party in August 2012 to carry out an user satisfaction survey on rehabilitation of road section from Kantale – Trincomalee at a total cost of Rs.3.2 million and expected to be charged against the proceeds of foreign loan. According to the Terms of Reference of the Agreement, all the activities of the survey should be concluded on or before 18 December 2012. However, the activities of the survey such as submission of completed electronic database and baseline survey report etc, had not been submitted even as at 30 April 2013.
- (c) The Project Director's Office is located at the third floor of the Sethsiripaya Building since 01 February 2011 and a sum of Rs.6.6 million had been paid to the Urban Development Authority (UDA) during the year under review to use 5100 square feet of the premises. However, action had not been taken to enter into a legal agreement with the UDA even upto 04 April 2013.

5.7 Extraneous Expenses

According to Paragraph 04 of the Appraisal Report of the Project, the PMU staff and the officers of the RDA who involved in environmental and social activities for road development purposes had been selected under the component of training and institutional strengthening, as parties needed for trainings. However, a sum of Rs. 834,949 had been spent out of the allocations made under the above mentioned component for participation of an Additional Director General of the MOPH to the International Programme on Procurement Procedure held in India in February 2012 which was not relevant to the environmental and social activities for road development purposes.

Further, reports on foreign visits made to Thailand in June 2012 by four officers of the Project had not been submitted as required by the Circular No CA/1//16/1 dated 09 July 2010 issued by the Presidential Secretariat.

5.8 Idle Assets

Lab equipment valued at Rs. 1.79 million purchased for the use of rehabilitations of road section from Ambepussa to Dambulla had been remained at a premises in Kurunegala from 15 February 2011 to 15 June 2012 and then transferred to a premises in Ja-Ela due to withdrawal of rehabilitation works of the respective road section from the original scope of the Project. The inventory items remained idle at the premises in Ja-Ela, since then. The sudden visits made by the audit team to Ja-Ela premises at the in April 2012, revealed that several items such as Marshall Test Equipment – Compactor, California Bearing Test Equipment, Los Angeles Abaration Machine and Trichloroethylene 200L barrel were remained outside of the premises without adequate protection from environmental and other effects.

6. Systems and Controls

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

- (a) Preparation of statements for replenishments
- (b) Management of the PCU
- (c) Assets Management
- (d) Contract Administration
- (e) Inventory Control
- (f) Accounting