

Improvement of National Road Network in Northern Province Project - 2013

The audit of financial statements of the Improvement of National Road Network in Northern Province Project 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. This Project is implemented under the Loan Agreement No.BLA 201006 dated 09 September 2010 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Export-Import Bank of China.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Ports and Highways, presently Ministry of Highways and Higher Education is the Executing 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 improvement of 10.8 kilometres of Oddusudan-Nedunkerni Road-(B334) and 41.8 kilometres of Mullaitivu-Puliyankulam Road-(B296). As per the Loan Agreement, the contract value of the Project is US\$ 50.0 million equivalent to Rs 5,928.30 million and out of that US\$ 42.5 million equivalent to Rs 4,880.11 million or 85 per cent was agreed to be financed by the Export-Import Bank of China. The preliminary works of the Project was commenced on 01 December 2010 and the contract was effected from 15 August 2011. The rehabilitation works of the roads were scheduled to be completed by 14 February 2014. However, such works had been completed on 27 June 2014 and the roads were handed over to the Road Development Authority.

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 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 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 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 identification of the purchases made out of 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 equipments 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 in accordance with Sri Lanka 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 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 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 Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purpose for which they were provided,
- (c) the 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 Loan Agreement had been complied with.

2.2 Comments of Financial Statements

2.2.1 Accounting Deficiency

As a practice, a provisional amount of gratuity for the staff of the Road Development Authority attached to the Project Monitoring Unit is remitted to the Road Development Authority by the Project. However, calculations for the provision for gratuity was based on the entire period of service of the staff members in the Road Development Authority and other projects as well instead of the period of service in the Project Monitoring Unit. Therefore, an additional sum of Rs. 74,137 had been remitted to the Road Development Authority.

2.2.2 Non- Compliance with Laws , Rules and Regulations

The following observations are made.

- (a) 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.
- (b) A sum of Rs.231,416 had been remitted during the year under review to the Road Development Authority as overhead charges contrary to the 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.

3. **Financial and Physical Performance**

3.1 **Utilization of Funds**

According to the information made available, certain significant statistics relating to the financing of the Project and the utilization of funds for the year under review are given below.

Source	Amount agreed to be financed according to the Loan Agreement		Funds utilized		
	US\$ million	Rs. million	utilized during the year 2013 Rs. million	up to 31 December 2013 US\$ million	Rs. million
Export and Import					
Bank of China	42.5	4,880.11	959.37	30.65	3,953.50
GOSL	7.5	1,018.19	18.23	7.45	960.60
	<u>50.0</u>	<u>5,898.30</u>	<u>977.60</u>	<u>38.10</u>	<u>4,914.10</u>

3.2 **Physical Progress**

The rehabilitation and improvement works of 52.6 kilometres of Mullaitivu-Pulliyankulam Road and Oddusuddan-Nedunkerny Road commenced on 15 August 2011 and roads had been handed over to the Road Development Authority on 27 June 2014 after completion of rehabilitation.

3.3 **Contract Administration**

The following observations are made.

- (a) As per Clause 114 of the Volume 3 of the Technical Specification, the responsibility to maintain the rehabilitated roads is vested with the contractor

and allocation amounting to Rs. 11.23 million had been made thereon. However, according to the Interim Payment Certificates, a sum of Rs. 27.26 million had been claimed by the contractor for the road maintenance purposes and the total amount claimed had been settled by the Project.

- (b) As per Clause 14.9 of the General Conditions of contract, the retention money shall be certified by the Engineer for payment to the contractor, after the expiry date of the defect liability period. However, the Project had released a portion of retention money amounting to Rs.143.53 million during the year under review by accepting a bank guarantee before the date of completion of defect liability period on 27 June 2014 .
- (c) It was revealed that the sections of the roads had been taken over by the Road Development Authority with substantial amount of rehabilitation works to be completed during the defect liability period as described below.

<u>Name of Road</u>	<u>Outstanding works to be completed at the time of taking over</u>
Mullativu - Puliyankulam Road	117
Oddusudan – Nedunkerny Road	<u>39</u>
Total	<u>156</u>

According to the audit point of view, a strong review procedures to be applied at the end of the defect liability period to ensure that the contractors attended to rectify the identified defects.

- (d) According to the Statement at Completion (SAC) submitted by the contractor, savings of Rs.20.28 million had been reported on cost of rehabilitation of road pavements due to over provisions made in the Bill of Quantities. Thus, indicated that the contractor had been given an opportunity for additional financial gains by granting mobilization advances which calculated based on higher cost of contract.
- (e) It was observed that the estimates for the road rehabilitation works had not been properly prepared, considering all the matters to ensure the accuracy of the total cost of the contract as required by the provisions made in the Public Finance Circular No.2/2012 of 11 August 2012. The scope of works for rehabilitation and improvement of Mullaitivu-Pulliyankulam Road and Oddusuddan-Nedunkerny Road had been changed subsequently and additional cost of Rs.3,055 million had been incurred thereon. In this regard, the explanations from the persons responsible had not been called for scope changes in accordance with the Clause No. 8.13.4 of the Procurement Guideline.

3.4 Matters in Contentious Nature

It was observed that the Project had rehabilitated 04 provincial roads in the Northern Province which were not recognized in the original scope of the works and a sum of Rs. 934.03 million had been spent thereon.

<u>Nature of the works</u>	<u>Amount spent Rs. million</u>
Rehabilitation roads in Puddukkudiyiruppu resettlement area	497.53
Rehabilitation of approach roads from A34 Road	63.78
Rectification of Asphalt surfacing on Trincomalee – Pulmudai Road	71.16
Rehabilitation of Road from Puddukkudiyiruppu to Padaviya junction	<u>301.56</u>
	<u>934.03</u>