

Northern Road Rehabilitation Project (Rehabilitation and Improvement of 90 Kilometres of Kandy - Jaffna Road) - 2013

The audit of financial statements of the Improvement of Northern Road Rehabilitation Project (Rehabilitation and Improvement of 90 Kilometres of Kandy - Jaffna Road) 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 as per the Loan Agreement No.BLA 201003 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, Objective, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Highways, Ports and Shipping, presently the Ministry of Higher Education and Highways was the Executing Agency and the Road Development Authority was the Implementing Agency of the Project. The objective of the Project was to rehabilitate and improve of 90 kilometres of Kandy-Jaffna Road between 230 kilometre post and 320 kilometre post. As per the Loan Agreement, the estimated cost of the Project was US\$ 83.0 million and out of that US\$ 70.6 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 scheduled to be completed by 20 August 2013. The rehabilitation and improvement works of the section of the Road had been substantially completed on 10 April 2013 and handed over to Road Development Authority. However, the financial statements for the year ended 31 December 2013 had been presented for audit.

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 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.
- (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 on the basis of 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 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 in 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 on Financial Statements

2.2.1 Accounting Deficiencies

The value of assets such as vehicles and equipments etc, procured through contractors and Consultants had been shown under the civil works completed instead of taking action to segregate the assets by verifying physically and shown values under Ledger Accounts of respective assets.

2.2.2 Non -Compliance with Laws, Rules and Regulations

The following instances of non- compliances were observed in audit.

- (a) Although the employees of the Road Development Authority attached to the Project are not entitled for other allowances in terms of Sections 8.3.9 and 8.6 of the Circular No PED/12 dated 02 June 2003, bonus and medical encashment aggregating to Rs. 173,863 had been paid to them.
- (b) Remunerations for the employees of the Road Development Authority attached to the Project had been calculated based on a formula introduced by

the Road Development Authority, contrary to the Circular No.33 of 05 April 2007 of the Department of Management Services. In this connection, remuneration aggregating Rs.16.71 million had been paid up to 31 December 2013 without being obtained proper authority.

- (c) The provision for gratuity amounting to Rs.1.69 million as at 31 December 2013 had been computed based on the entire period of service of the staff members of the Road Development Authority who released for the Project purposes, instead of considering the period of service in the Project Monitoring Unit.
- (e) In addition to above, a sum of Rs. 1.44 million had been remitted to the Road Development Authority by the Project as overhead charges, contrary to the instructions made in paragraph 8.3.9 of the Circular No. PED/12 of 02 June 2003 of the Department of Public Enterprises.
- (f) As specified in the Section 5.4.4 of the Procurement Guidelines, mobilization advance for works should be paid on contract value excluding provisional sum and contingencies. However, mobilization advance amounting to Rs.2,859 million had been paid on 30 per cent of total contract value of which included provisional sum of Rs.837.43 million and contingencies amounting Rs. 251.23 million, contrary to the above mentioned instructions.

3. Financial and Physical Performance

3.1 Utilization of Funds

According to the information made available, certain significant statistics relating to the financing and the utilization of funds of the Project during the year under review and as 31 December 2013 is shown below.

<u>Sources</u>	<u>Amounts agreed to be</u>		<u>Funds utilized</u>		
	<u>financed according to the</u>		<u>during the</u>	<u>as at 31 December</u>	
	<u>Loan Agreement</u>		<u>year 2013</u>	<u>2013</u>	
	<u>US\$</u>	<u>Rs.</u>	<u>Rs.</u>	<u>US\$</u>	<u>Rs.</u>
	<u>million</u>	<u>million</u>	<u>million</u>	<u>million</u>	<u>million</u>
Export-Import Bank of China	70.58	8,387.07	1,646.45	63.40	8,242.09
GOSL	12.45	1,798.93	40.47	13.04	1,694.84
	-----	-----	-----	-----	-----
	<u>83.03</u>	<u>10,186.00</u>	<u>1,686.92</u>	<u>76.44</u>	<u>9,936.93</u>

3.2 Physical Performance

According to the information received, the rehabilitation works of the section of the Road had been substantially completed and handed over to the Road Development Authority on 10 April 2013.

3.3 Contract Administration

The following observations are made.

- (a) The Non- conformation Letters issued by the Consultant had not been prepared in accordance with the standard format and as a result, the details of descriptions on works, required to be rectified and the proposed method of corrective actions etc could not be made available for audit.
- (b) The contractor had revised and redesigned of works as per instructions given by the Project Engineer and the claims had been made for extra works valued at Rs. 11.61 million on preparation of designs for pavements, hydrological studies, surveying and designing of improvements of the Road for 04 lanes in Kilinochchi area and reconstruction of 05 bridges etc. The cost incurred on the above extra works could have been minimized if the proper attention had been made at the earlier stages of designing works.
- (c) According to the Bill of Quantities, a sum of Rs.130 million had been allocated for the maintenance of carriageway. However, according to the final statements for works completed had indicated that a sum of Rs.426 million representing the increase of 227 per cent of the original allocation had been spent thereon.
- (d) As per the Clause 14.9 of the general conditions of contract, the final portion of retention money shall be certified by the Engineer for payment to the Contractor after the expiry date of the defect liability period. However, before the end of the defect liability period on 30 September 2014, a portion of retention money amounting to Rs.238.32 million had been released by accepting a bank guarantee.

3.4 Transaction in Contentions Nature

The following observations are made.

- (a) According to the summary of the list of defects of the Road, a considerable number of road studs were damaged due to lower quality of the road studs. Further, it was revealed in audit that the different type of road studs than the specifications had been used by the contractor and a sum of Rs 42.47 million

had been paid thereon. However, action had not been taken to rectify the defects and re-fixed the road studs according to the specifications.

- (b) According to the Clause 13.6 of the Condition of Contract, the variations shall be executed on a day works basis for works in minor or incidental nature and provisions amounting to Rs.51.89 million had been made in the Bill of Quantities thereon. According to the Statement of Completion submitted by the contractor, variation of works valued at Rs. 108.88 million representing 109 per cent increase of initial allocation had been claimed under day work basis, exceeding the above provisions. Further, it was revealed that many of such works were not minor or incidental in nature and formal variation order had not been raised for these variations.