

China Development Bank Funded Priority Road Project 3 - (Phase I) - 2014

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase I) for the first accounting period from 09 September 2014 to 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 Loan Facility Agreement No. 4510201401100000245 dated 11 March 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Facility Agreement of the Project, the Ministry of Higher Education and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve mobility of the National Highway Network of the country through the rehabilitation of sections of road selected on a priority basis spread throughout the country thereby facilitating access to vital services and contributing to economic development activities. As per the Loan Facility Agreement, the estimated total cost of the Project was US\$ 357.68 million equivalent to Rs.46,184.54 million and out of that US\$ 300 million equivalent to Rs.38,736 million was agreed to be provided by the China Development Bank. The Project commenced its activities on 09 September 2014 and scheduled to be completed by 17 July 2017.

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 Facility 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 Public Sector Accounting Standards and
- (h) Whether the financial covenants laid down in the Loan Facility 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 period 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 and
- (c) the financial covenants laid down in the Loan Facility Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

Value of the mobilization advances aggregating 11,172 million shown in the financial statements had been overstated by Rs.3,319 million, as a result of the mobilization advances scheduled to be paid in 2015 for the contracts on rehabilitation of 07 roads had been brought to account as payable at the end of the period under review.

2.2.2 Non - Compliance with Laws, Rules and Regulations

The allocations made for the provisional sums and contingencies etc, had been considered as a part of the cost of contracts, contrary to the Section 5.4.4 of Government Procurement Guidelines and 30 per cent of mobilization advances had been calculated accordingly. As a result, the mobilization advances aggregating Rs 1,655.27 million on 07 contracts awarded by the Project had been overpaid during the period under review.

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 up to 31 December 2014 are shown below.

Source	Amount agreed for financing according to the Loan Facility Agreement		Allocation made in the Budget Estimate for the period under review	Funds utilized as at 31 December 2014	
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million
China Development Bank	300.00	38,736.00	2,858.80	21.93	2,858.75
GOSL	<u>57.68</u>	<u>7,448.54</u>	<u>1,100.00</u>	<u>4.54</u>	<u>591.53</u>
	<u>357.68</u>	<u>46,184.54</u>	<u>3,958.80</u>	<u>26.47</u>	<u>3,450.28</u>

3.2 Physical Progress

The contracts for rehabilitation works of 11 roads with the length of 219.94 kilometres had been awarded during the period under review, out of 13 roads with the length of 248.19 kilometres scheduled to be rehabilitated under the Project.

3.3 Contract Administration

The Project had spent a sum of Rs.16.11 million additionally, on rehabilitation works carried out at Ratnapura-Palawela-Karawita Road due to additional excavation of 10,412 cubic metres of roadway and the calculation errors made in the measurement sheets.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) Although the activities of the Project had been commenced on 09 September 2014, the Project had taken action to get the approval from the Department of Management Services for the cadre of the Project only on 20 March 2015. However, the Project had deployed 106 persons as at 31 December 2014. The approval of the Department of Management Services had been received on 20 July 2015 to recruit persons for 260 cadre positions of the Project.
- (b) Advertisement charges amounting to Rs.2.14 million on opening of Badulla-Mahiyangana Road rehabilitated under Priority Road Project - 2 had been charged as the cost of Galle-Udugama Road scheduled to be rehabilitated under this Project.