

Eastern Province Rural Road Development Project - 2014

The audit of the financial statements of the Eastern Province Rural Road Development Project for the year ended 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 Section 4.7 (a) of Article III of the Loan Agreement No. SL-P 97 dated 26 March 2010 entered into between the Democratic Socialist Republic of Sri Lanka and the Japan International Cooperation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Eastern Province Rural Road Development Project, the Ministry of Finance is the Executing Agency and Eastern Provincial Council is the Implementing Agency of the Project. The objective of the Project is to improve the livelihood of the people in the Eastern Province by improving access to economic activities and market facilities as well as by improving access to social services through rehabilitation of rural roads and thus to contribute to local economic development and mitigating regional inequality. As per Loan Agreement, the estimated total cost of the Project was Japan Yen 4,664 million equivalent to Rs.5,834 million and out of that, Japan Yen 3,965 million equivalent to Rs.4,944 million was agreed to be financed by the Japan International Cooperation Agency. The Project commenced its activities on 26 March 2010 and scheduled to be completed by January 2014. However, the financial statements for the year ended 31 December 2014 had been submitted 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 Generally Accepted Accounting Principles 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 Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (f) Whether the funds, materials and equipments supplied under the Loan had been utilized for the purposes of the Project,
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (h) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) 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 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 2014 and the financial statements give a true and fair view of state of affairs of the Project as at 31 December 2014 in accordance with Generally Accepted Accounting Principles.
- (b) the funds provided had been utilized for the purposes for which they were provided.
- (c) the Statement of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement.
- (d) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

The interest charges of Japan Yen 7,008,734 and commitment charges of Japan Yen 196,032 paid to the Lending Agency during the year under review had not been brought to account.

2.2.2 Non-compliance with Laws, Rules and Regulations

The following observations are made in this regard.

- (a) According to Section 1 of Schedule 2 of the Loan Agreement, local taxes and duties are not eligible for financing from the proceeds of the Loan. However, Construction Industry Guarantee Fund Levy amounting to Rs.6.06 million had been reimbursed from the proceeds of the Loan.

- (b) Board of Surveys had not been carried out at the end of the year under review in terms of Financial Regulation No. 756 relating to fixed assets valued at Rs.6.46 million.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed to be financed according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Fund Utilized</u>			
	Japan Yen million	Rs. million		Rs. million	during the year 2014		as at 31 December 2014
	Japan Yen million	Rs. million	Rs. million	Japan Yen million	Rs. million	Japan Yen million	Rs. million
JICA	3,965	4,944	575	448	570	3,865	5,600
GOSL	699	890	304	186	232	577	836
Total	<u>4,664</u>	<u>5,834</u>	<u>879</u>	<u>634</u>	<u>802</u>	<u>4,442</u>	<u>6,436</u>

3.2 Physical Progress

According to the progress reports of the Project, 97 rural roads with the length of 109 kilometres in Trincomalee district, 161 rural roads with the length of 134 kilometres in Batticaloa district and 71 rural roads with the length of 116 kilometres in Ampara District had been reconstructed by paving concrete during the period of the Project. However, according to the initial plans of the Project, 91 rural roads with the length of 110 kilometres in Trincomalee district, 150 rural roads with the length of 117 kilometres in Batticaloa district and 64 rural roads with the length of 116 kilometres in Ampara District were expected to be reconstructed.

3.3 Contract Administration

It was observed in audit that the monitoring and follow up actions taken by the Eastern Provincial Council relating to the contract administration and quality management of roads reconstructed by the Project was not adequately done due to lack of procedures thereon developed by the Provincial Council. As a result, several deficiencies such as selection of unqualified contractors, quality failures of the roads reconstructed etc, were observed in audit. Instances observed during the course of audit are given below.

- (a) It was observed in site visits made by the auditors that the quality tests had not been carried out on compaction, mixing of concrete and quality of the material used for the rehabilitation of Ethabendiwewa Middle Road in Trincomalee district. According to the reports of the National Building Research Organization, concreting from 0+100 metre to 0+310 metre of the Road was not done satisfactory due to poor mixing of concrete and inferior quality of the material used. Therefore, defects had to be rectified by overlaying of 100 mm thickness concrete. However, the Bitumen had been applied on the surface of the concrete at locations from 0+000 metre to 0+700 metre of the Road to rectify the defects.
- (b) According to Section 5.4.4 of the Procurement Guidelines – 2006, the advance payments should have been recovered before making 90 per cent of the payments to the contractor. However, a sum of Rs.1.27 million representing 38 per cent of the total advance paid for the improvement of first lane of the Ethabandiwewa Road and Rotawewa Road in Trincomalee district had only been recovered from the contractors at the time of payment of the final bills. According to the Project Director, the outstanding balance of advances had been recovered subsequently.
- (c) The lowest quoted price of Rs.54.9 million had been selected for the reconstruction of 10 rural roads with the length of 4.06 kilometres in the Divisional Secretariat Division of Manmunai North in Batticaloa district, out of 05 bids received thereon. However, it was revealed in audit that rates for works quoted in the bids had been altered twice, subsequently. As a result, the lowest quoted price had been increased up to Rs. 91.5 million with the recommendations and approvals of the Technical Evaluation Committee and Procurement Committee. Further, it was revealed in audit tests that the bidders had not submitted copies of bidding documents under a sealed cover as required by the Section 6.3.1 of the Government Procurement Guideline – 2006.

3.4 Matters in Contentious Nature

The following matters were observed in audit.

- (a) Requests made by the Project to mobilize guarantee bonds on advances aggregating Rs. 54.63 million made to the contractor engaged in 09 contracts had been refused by the Commercial Banks and stated that such bonds were not genuine and not issued by the respective Commercial Banks.
- (b) The validity period of performance bonds valued at Rs. 30.79 million relating to 09 contracts awarded by the Project had been expired in 2014 and the requests made by the Project to extend the validity periods had been further refused by the Commercial Banks due to the suspicious nature of the documents. However, the Project had accepted fresh performance bonds

issued by an Insurance Company in private sector, without taking action against the contractor for the misrepresentations made and contrary to clauses of the Letter of Acceptance which prohibited to accept performance bonds from the Insurance Companies.

- (c) According to Section 7.8 of the Government Procurement Guidelines, the bids should be rejected and not taken for further consideration if the bidder had not signed in the bid documents. However, the Project had awarded 03 contracts at estimated costs of Rs.316 million on rehabilitation works of the roads in Batticaloa district to the bidders who had not placed their signatures on bid documents.

3.5 Preparation of Winding up Accounts of the Project

Eventhough the activities of the Project had been concluded and assets had been handed over to the Implementing Agency as at 31 December 2014, the financial statements of the Project for winding up purposes had not been prepared and presented.