

## **Improvement of Northern Road Rehabilitation Project (Rehabilitation and Improvement of Mullaitivu-Kokkilai - Pulmodai Road) - 2014**

---

The audit of financial statements of the Improvement of Northern Road Rehabilitation Project (Rehabilitation and Improvement of Mullaitivu-Kokkilai-Pulmodai Road) 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. This Project is implemented as per the Loan Agreement No.BLA 201005 dated 09 September 2010 entered into between the Democratic Socialist Republic of Sri Lanka 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 Road Development Authority is responsible for the management and coordination of activities of the Project at national level. The objective of the Project is to rehabilitate and improve of 42.4 kilometres of Mullaitivu-Kokkilai-Pulmodai Road. As per the Loan Agreement, the contract value of the Project is US\$ 50.3 million and out of that US\$ 42.8 million or 85 percent 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 14 August 2013. The rehabilitation works the section of the Mullaitivu-Kokkilai-Pulmodai Road had been completed and taken over by the Road Development Authority on 13 August 2013. However, the Project had continued its operations to rehabilitate other roads and financial statements for the year ended 31 December 2014 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 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 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 per the consultancy and civil works contract agreement, the assets such as vehicles, equipment, furniture etc., purchased by the contractor and the Project, out of the funds provided by the Project are the properties of the Project. However, 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 recognize the value of assets separately and bring it into account accordingly.

## 2.2.2 Non - Compliance with Laws, Rules and Regulations

A sum of Rs 1.21 million had been remitted by the Project as a recovery of overhead costs of the Road Development Authority, contrary to the Section 8.3.9 of the Circular No. PED/12 dated 02 June 2003 of the Department of Public Enterprises. Further, the bonus and medical allowance of Rs. 171,734 had been paid to the staff of the Road Development Authority attached to the Project which was not permitted in terms of the Section 8.6 of the said Circular. Eventhough the above instances of non – compliance were highlighted in my previous audit reports, such practices were continued even during the year under review without taking remedial actions.

## 3 Financial and Physical Performance

### 3.1 Utilization of Funds

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

Source	Amount agreed for financing according to the Loan Agreement		Funds utilized during the year 2014 up to 31 December 2014			
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
Exim Bank of China	42.80	5,777	10.25	1,342.2	41.05	5,315.2
GOSL	7.50	1,059	0.11	14.8	7.54	972.8
	<b>50.30</b>	<b>6,836</b>	<b>10.36</b>	<b>1,357.0</b>	<b>48.59</b>	<b>6,288.0</b>

### 3.2 Physical Progress

The rehabilitation and improvement works of 42.4 kilometres of Mullaitivu-Kokkilai-Pulmodai Road had been completed and handed over to the Road Development Authority on 13 August 2013. Further, the other works of construction of bridges at Nayaru and Alampil, rehabilitation of internal roads in Mullathivu, and rehabilitation of roads of Pudukudurripu-Oddusudan and Padaviya-Siripura which were not included in the original work plan had also been carried out by the Project in 2013 at a cost of Rs.116.79 million. In addition, a sum of Rs.824.31 million had been spent during the year under review for rehabilitation of 19.8 kilometres of a provincial road from Kohombagashandiya to Nelumwewa. Eventhough these

additional works had been treated as variations for the main works, the approvals from relevant parties had not been obtained for such works.

### **3.3 Contract Administration**

The following observations are made.

- (a) According to the Bill of Quantities, a sum of Rs.2,019 million had been allocated for reconstruction of 42.4 kilometres of road pavements of Mullativu-Kokilai-Pulmudai Road. However, according to the final Interim Payment Certificate submitted on 13 August 2013, a sum of Rs.367.75 million had only been spent thereon. The Project Director had explained that the scope of the works had been changed from Double Bitumen Surface Treatment to Aggregate Base Course and as a result, savings could be made. However, it was observed that the mobilization advance had been calculated based on unrealistic cost estimates and overpayments made thereon.
- (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.9 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. 16 million 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 orders were not raised for these variations.
- (c) It was observed at the physical observation that there were several cracks and damages at the edges of Kohombagahashandiya to Nelumwewa Road from 17+000 kilometre to 19+000 kilometre thus it revealed that quality of the rehabilitation works of the road was not assured adequately.

### **3.4 Transaction in Contentious Nature**

According to the financial statements presented, the Project had obtained a Special Loan of Rs.2.74 million from the Road Development Authority. However, the rehabilitation works of the roads carried out by the Project had been completed as at 27 June 2014 and action had not been taken to settle the Loan.