

## **Road Sector Assistance Project - 2014**

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The audit of financial statements of the Road Sector Assistance 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 4.01(b)(i) of Article IV of the Development Credit Agreement No.4138-CE dated 16 January 2006 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association.

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

According to the Development Credit Agreement of the Road Sector Assistance Project, the Ministry of Highways and Road Development, presently the Ministry of Highways and Investment Promotion is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to lower transportation cost through sustainable delivery of an efficient national road system. According to the Development Credit Agreement, the estimated total cost of the Project amounted to SDR 69,100,000 equivalent to US\$ 100 million or Rs.10,125 million and the entire amount was agreed to be financed by the International Development Association. Further, an additional allocation of SDR 59,600,000 equivalent to US\$ 98.1 million or Rs.11,579 million had been provided under the First Supplementary Development Credit Agreement No.4429 CE dated 23 June 2008 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. Further, the Second Supplementary Development Credit Agreement No.4906 CE had been entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association on 15 March 2011 and an additional allocation of SDR 63,600,000 equivalent to US\$ 100 million or Rs.11,081 million had been made thereon. Initially, the Project commenced its activities on 16 January 2006 and was scheduled to be completed by 31 March 2011. However, the Project period had been extended up to 30 June 2015 in terms of provisions made in the Second Supplementary Development Credit Agreement.

### **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 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 the 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 purchases made out of the Loan, etc,
- d) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Development Credit Agreements,
- 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,
- 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 Development Credit Agreements 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 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,
- (c) 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 Development Credit Agreements,
- (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 Development Credit Agreements had been complied with.

## **2.2 Comments on Financial Statements**

### **2.2.1 Accounting Deficiency**

Although the fixed assets procured at a cost of Rs.244,228,424 had been physically transferred to the Road Development Authority, Ministry of Highways and Investment Promotion and the Road Maintenance Trust Fund since the year 2010, necessary adjustments had not been made in the accounts to dispose of the value of such assets. Further, provision for depreciation amounting to Rs.119,874,924 thereon had been made in the financial statements. Although physical verification of the assets of the Project Management Unit for the year under review had been carried out by the Project, physical existence of the assets handed over to the Road Development Authority and the Line Ministry had not been verified.

### **2.2.2 Non - compliance with Laws, Rules and Regulations**

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

- (a) According to Circular No.33 dated 05 April 2007 of the Department of Management Services, staff recruitment should be made by calling for applications through National Newspapers and appoint the officers on contract basis not exceeding three years period. However, the entire staff of the Project was consisted with the officers released from the Road Development Authority on temporary basis , contrary to the above provisions. According to the said Circular, the officers attached to the Government Owned Institutions should be released to the Projects on full time basis for a maximum period of 5 years during the period of service in public service. However, the staff of the Project Monitoring Unit who were released from Road Development Authority had been engaged on part time basis.
- (b) Although a sum of Rs.16.17 million had been spent during the year under review, for foreign training for 07 officers including an officer of the Ministry of Highway and Investment Promotion and another officer of Road Development Authority a test examination revealed that the respective training programme was not directly related to activities of the project Further, the reports required to be furnished within 7 days after returning to the island had not been submitted by the participants as required by the Circular No. CA/1/1/16/1 dated 09 July 2014 of the Secretary to the President.

## **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 during the year under review and up to 31 December 2014 are shown below.

Source	Amount agreed for financing according to the Development Credit Agreements		Funds utilized during the year 2014		Funds utilized up to 31 December 2014	
	US\$ millions	Rs. millions	US\$ millions	Rs. millions	US\$ millions	Rs. millions
International Development Association Loan Nos.						
4138 CE	100.0	10,125	1.12	145.8	75.3	9,787
4429 CE	98.1	11,579	1.00	137.2	83.9	10,912
4906 CE	100.0	11,081	25.87	3,363.3	61.2	7,960
Exchange Difference	-	-	0.05	7.6	3.0	398
Government of Sri Lanka	-	-	0.4	64.0	52.0	6,771
	<b>298.1</b>	<b>32,785</b>	<b>28.44</b>	<b>3,717.9</b>	<b>275.4</b>	<b>35,828</b>

It was observed that 03 Special (Dollar) Accounts had been maintained by the Project under each Project Agreement and balances aggregating US\$ 18,199,332.71 equivalent to Rs.2,384,997,072 had remained in the Dollar Accounts at the Central Bank of Sri Lanka as at 31 December 2014.

### 3.2 Physical Progress

The following observations are made.

- (a) According to the information received, physical progress over 90 per cent of all rehabilitation works of 04 national roads implemented by the Project had been reported as at 31 December 2014. However, time extensions over 02 months had been granted to the contractors engaged for such construction works.
- (b) In addition, construction works of the overhead bridge across Colombo – Galle- Hambantota Road at Panadura Town which was expected to be completed by 31 December 2014 had shown the physical progress of 84 per cent only as at 31 December 2014.

### **3.3 Contract Administration**

The following observations are made.

- (a) It was observed that the variations of cost of rehabilitation works of 04 roads had remained as at the date of substantial completion ranging from 12.6 per cent to 18.3 per cent over originally estimated cost of such works. However, it was observed that variations aggregating Rs.603.82 million had been approved after substantially completion of the road works. The Project Director had explained that such variations had arisen due to improvements made on public utility services and as a result of addressing the requests made by the general public. Thus indicating that proper surveys on road works and costs thereon had not been carried out at the initial stages to avoid subsequent cost variations.
- (b) It was revealed in audit that the instructions issued by the consultants to remove the substandard Asphalt binder course at several locations of Peliyagoda – Puttalam Road and Colombo- Galle- Hambantota Road based on Non-conformance Report. However, it was observed that the contractors had laid Asphalt wearing course without removing the substandard Asphalt binder course.
- (c) The joint inspection made by the auditors with the officers of the Research and Development Division of the Road Development Authority on 12 March 2014 revealed that the paints used for road marking purposes had not complied with the standard specification made by the Road Development Authority. Further, the quality test carried out on material extracted from 03 locations of the above mentioned road proved that the quality of the material used remained below the standards.
- (d) A contract on construction of an overhead bridge with escalator facility across the Colombo- Galle-Hambantota Road at Panadura Town had been awarded by the Project on 21 February 2014 and the following observations thereon are made.
  - (i) According to the report dated 15 January 2010 submitted by the Transportation Research and Study Centre of University of Moratuwa, the construction of a flyover across Colombo- Galle- Hambantota Road to improve vehicle movement in Panadura Town had been recommended. However, the Project had introduced escalator facility to the overhead bridge without carrying out a feasibility study and cost benefit analysis etc.

- (ii) The revised detailed work plan relating to the variation of the scope of work by introducing escalator facility had not been prepared and submitted by the contractor as required by the Section 8.1. and 8.2 of the General Condition of the Contract Agreement. Further, the quality assurance plan required to be submitted by the contractor in terms of Clause No 4.9 of the Contract Agreement had not been submitted to the Project by the contractor. The works on providing escalator facility was not supervised by the Consultant as it was not covered by the Consultancy Agreement.
- (e) Although a sum of Rs.9,384,000 had been paid to a consultant since July 2012 up to 31 December 2014 as local consultancy charges, any documentary evidence in support for the involvement of the works of the consultant for the activities of the Project, according to the Terms of Reference included in the Consultancy Agreement was not made available for audit.

### **3.4 Idle Assets**

The pipe laying material procured at a cost of Rs.84,001,283 remained idle at the Project premises for over 02 years.

### **3.5 Extraneous Activities**

A sum of Rs2.05 million spent by the Project on renovation of stores of the Research and Development Section of Road Development Authority and construction of wire fence and boundary wall of the office of Road Development Authority in Negombo did not directly relate to the activities of the Project.

### **3.6 Transactions of Contentious Nature**

The following observations are made.

- (a) As a result of different rates applied for calculation of Value Added Taxes, a sum of Rs.776,000 had been underpaid to a contractor as Value Added Tax on interim payments made.
- (b) As a practice, contribution for the gratuity for the members of the staff released from the Road Development Authority is remitted by the Project periodically. It was observed that the calculation of gratuity had been based on the entire period of service of the staff members including the service at the Road Development Authority instead of the period of service at the Project Monitoring Unit. Therefore, an additional sum of Rs.6.96 million had been remitted up to 31 December 2014 for 22 officers of the Road Development Authority.

- (c) The incentives amounting to Rs.539,734 for the staff of the Road Development Authority attached to the Project and cost of overhead expenditure of Rs.1,376,971 had been reimbursed by the Project, contrary to the provisions made in the Sections 8.3.9 and 8.6 of the Public Enterprises Circular No. PED/12 dated 02 June 2003.

### **3.7 Uneconomic Transactions**

The Project had entered into agreements with service suppliers to hire 09 motor vehicles and a sum of Rs.11,088,132 had been spent during the year under review thereon . It was observed that the Project had not utilized such vehicles to cover minimum number of kilometres to be run per month and as a result, a sum of Rs.1,039,534 had been overpaid for 48,418 kilometres not used for running during the year under review.