

National Highways Sector Project - 2015

The audit of financial statements of the National Highways Sector Project for the year ended 31 December 2015 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 34 of Schedule 6 of the Loan Agreement No. 2217 SRI dated 14 December 2006 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Ports and Shipping, presently the Ministry of Higher Education and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objectives of the Project are to improve the National Highways Network efficiency and strengthen Road Sector Institutions. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 216 million equivalent to Rs. 23,760 million and out of that US\$ 150 million equivalent to Rs.16,500 million was agreed to be financed by the Asian Development Bank. A Memorandum of Understanding was signed by the Government of Sri Lanka with the Asian Development Bank on 15 February 2008 and Loan Agreement had been amended accordingly on 27 May 2008 to change the scope of the Project within the original Loan amount. In addition to the above, another Loan Agreement No. 1355P had been signed by the Government of Sri Lanka with OPEC Fund for Economic Development on 04 October 2010 and agreed to be allocated US\$ 8 million equivalent to Rs.880 million by the OPEC Fund for Economic Development through this Project. As per the Loan Agreement, the Project activities had been commenced on 07 April 2006 and scheduled to be completed by 31 December 2012. The financing arrangements of OPEC Fund for Economic Development had been closed on 30 June 2015. However, the financial statements of the Project for the year ended 31 December 2015 had been prepared and 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 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 Loans etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreements.
- (e) Whether the funds, materials and equipment supplied under the Loans 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 the financial covenants laid down in the Loan 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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 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 Loan 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 Loan Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1.1 Accounting Deficiency

A sum of Rs. 3.90 million spent by the Project to meet the costs of electricity, water, security and cleaning charges etc. for newly constructed building for Highways Secretariat had been recognized as capital cost.

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 2015 are shown below.

| Source | Amount agreed for financing in the Loan Agreements | | <u>Funds utilized</u> | | | |
|--------|---|----------------|-----------------------|----------------|---------------------------|----------------|
| | | | during the year 2015 | | up to 31 December 2015 | |
| | US\$ million | Rs. million | US\$ million | Rs. million | US\$ million | Rs. million |
| ADB | 150.00 | 16,500 | - | - | 150.00 | 17,272 |
| OFID | 8.00 | 880 | - | - | 8.00 | 928 |
| GOSL | 58.00 | 6,380 | 6.79 | 964.39 | 64.04 | 9,090 |
| | <u>216.00</u> | <u>23,760</u> | <u>6.79</u> | <u>964.39</u> | <u>222.04</u> | <u>27,290</u> |

3.2 Physical Progress

According to the Implementation Plan of the Project, it was expected by the Project to rehabilitate 06 national roads and construct Highways Secretariat Building. According to the information received, all the road rehabilitation works had been completed by the Project even as at 31 December 2014. However, the constructions works of stage- iii of the Secretariat Building had been continued up to 31 December 2015 out of the contribution of the Government of Sri Lanka.

3.3 Contract Administration

The following observations are made.

- (a) The contract for the construction of the Building for Highways Secretariat had been awarded to a private party at a cost of Rs.599.30 million on 17 August 2010 to complete first three levels, out of all eight levels of the building and expected to be completed by 04 November 2011. However, at the time of 90 per cent of completion the construction of three levels, contract for construction of other five levels had been awarded to the same contractor at an additional cost of Rs.568.14 million, as a variation to the first contract. Further, the Project Monitoring Unit had decided in June 2012 to extend the building for further two levels at an estimated cost of Rs.795.72 million. Therefore, the total anticipated cost of the Building comprised with all ten levels was Rs.2,506.54 million. The approval of the Cabinet of Ministers for all stages above mentioned had been obtained to incur the additional cost from the contribution of the Government of Sri Lanka. The following further observations are made thereon.
 - (i) It was observed that the changes on the scope of the construction works had been made regularly and such practice allowed rooms to apply different rates ranging from 13 per cent to 68 per cent on the additional construction works carried out under stage-iii of the Building.

- (ii) It was observed that the several accessories such as generators, underground fuel tank, data network, server systems, elevators and air conditioning system etc had been procured at a cost of Rs. 495.39 million through the contractor and treated as the variation for the main contract for the construction of the Building, as such items were not included in the original Bill of Quantities. Therefore, the contractor was allowed to claim additional charges up to 35 per cent on overhead, fixing charges and margins for profits etc,. In addition, the space for the car parking purposes had not been planned and additional location need to be provided for that purpose.
 - (iii) The defects of several equipments and fittings of the Building such as data network system, server system, public addressing system, electrical installation, air conditioning system, elevators etc procured at a cost of Rs.259.42 million were observed at the site visits made by the auditors. However, it was further observed that the actions could not be taken to rectify the defects, as such equipment and fittings were remained idle for long period at the construction site and warranty periods were expired as at 31 December 2015.
 - (iv) Eventhough the contractor had agreed by the Letter No. C/369/10/HSB-HO/2013 of 17 November 2012 not to furnish any additional claims over the amount agreed for construction works under stage-iii of the Building, an additional claims aggregating Rs.6.14 million had been made during the year under review for retaining of workers, material at sites and transport charges etc,.
 - (v) According to the clause 14.10 of the contract agreement, contractor should submit the statement of completion, at the end of the contract period. However, the contractor had submitted final bill valued at Rs.2,057 million without submitting of statement of completion as at 31 December 2015.
- (b) Eventhough a consultancy contract had been awarded for interior designing works of the Secretariat Building and a sum of Rs. 21.03 million had been paid thereon as at 31 December 2015, the Consultant had not submitted lay-out plan and necessary drawings as required by the consultancy agreement. However, a contract had been awarded to other party on 17 February 2015 to supply furniture and equipment at a cost of Rs. 87.13 million and the contract could not be completed even up to 30 April 2016 due to lack of lay-out plans. Further, the variations of Rs. 26.73 million on supply of furniture and other variations of Rs. 39.63 million on supply and fixing of ceiling for 06 floors of the Building had been approved by the Project Director and paid, contrary to the paragraph 8.13.4 of the Government Procurement Guideline.

3.4 Closure of the activities of the Project

Eventhough the financing arrangements of the Lending Agencies were closed as at 30 June 2015, action had not been taken to prepare and present winding up accounts after transferring of the assets and liabilities of the Project to the Implementing Agency.