

China Development Bank Funded Priority Road Project 3 - (Phase II) -2016

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase II) for the year ended 31 December 2016 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. 4510201401100000587 dated 24 November 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation (CDBC).

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 reconstruct and rehabilitate existing national roads and rural roads providing crucial accessibility and is measured by the quality of transport infrastructure and services available improved access will provide number of social and economic benefits to the people who living in the area. As per the Loan Facility Agreement, the estimated total cost of the Project amounted to US\$ 117.67 million equivalent to Rs.15,590.61 million and out of that US\$ 100 million equivalent to Rs.13,253 million was agreed to be provided by the China Development Bank Corporation.

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 risk of material misstatements 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 equipment 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 the 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 Facility Agreement had been complied with.

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, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2016 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2016 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 submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Facility 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 Facility Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

Balances aggregating Rs.21.05 million payable to the outside parties as at 31 December 2016 had not been brought to the financial statements.

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 2016 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
CDBC	100.00	13,253.00	2,250.00	14.86	2,193.97	14.86	2,193.97
GOSL	17.66	2,337.61	350.00	-	348.50	-	371.31
Total	<u>117.66</u>	<u>15,590.61</u>	<u>2,600.00</u>	<u>14.86</u>	<u>2,542.47</u>	<u>14.86</u>	<u>2,565.28</u>

3.2 Physical Progress

The following observations are made.

- (a) The comprehensive overall plan and action plan had not prepared by the Project to identify the responsibilities of the core staff and physical and financial targets to be achieved and as a result, the progress of the Project as a whole could not be monitored and evaluated in effective manner.
- (b) The reconstruction works of 08 national and rural roads in Hambantota district were curtailed and transferred the allocations made thereon amounting to Rs. 15,151.83 million to carry out construction works of 80.60 kilometres of other 09 national roads and 48.25 kilometres of 11 rural roads in Kandy and Kegalle districts without being obtained the concurrence of the Lending Agency. According to the information received, the physical progress of 2.71 per cent and 4.26 per cent of the national roads and rural roads respectively had only been achieved as at 31 December 2016.

3.3 Human Resources Management

The following observations are made.

- (a) It was observed that the positions of the key managerial positions of the Project such as Deputy Project Director, 02 Senior Engineers, Project Accountant etc had remained vacant over 06 months as at 31 December 2016.
- (b) The Project had recruited 02 officers exceeding the cadre approved by the Department of Management Services and salaries aggregating Rs. 861,415 had been paid during the year under review.

3.4 Issues in Financial Control

The Fixed Assets Register had not been maintained by the Project in an updated manner, as required by Financial Regulation No 751.