

## **National Highways Sector Project - 2016**

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The audit of financial statements of the National Highways Sector Project 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 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, 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\$ 208 million equivalent to Rs.21,655 million and out of that US\$ 150 million equivalent to Rs.15,275 million was agreed to be provided by the Asian Development Bank. In addition to the above Loan, 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. As per the initial Loan Agreement, the activities of the Project 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. Subsequently, the period of the Project had been extended up to 31 December 2016.

### **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 Loans 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.

## **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 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 Agreements had been complied with.

## 2.2 Comments on Financial Statements

### 2.2.1 Accounting Deficiency

The consultancy fees for interior designing of the building for Highways Secretariat amounting to Rs.19.112 million had been erroneously accounted under other Project called National Highways Sector Project- Additional Financing

## 3. Financial and Physical Performance

### 3.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, 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 as per the Loan Agreement		Allocation made in the Annual Budget Estimate during the year under review	<u>Funds utilized</u>			
				during the year 2016		up to 31 December 2016	
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ADB	150.00	15,275	-	-	-	150.00	17,272
OFID	8.00	880	-	-	-	8.00	928
GOSL	58.00	6,380	284.45	0.59	86.75	62.07	9,177
<b>Total</b>	<b><u>216.00</u></b>	<b><u>22,535</u></b>	<b><u>284.45</u></b>	<b><u>0.59</u></b>	<b><u>86.75</u></b>	<b><u>220.07</u></b>	<b><u>27,377</u></b>

### 3.2 Physical Progress

According to the information received, the improvement works of the 06 national roads with the length of 353 kilometres had been completed and handed over to the Road Development Authority only on 31 December 2014. Further, the construction works of the building for Highway Secretariat had been completed as at 31 December 2016. However, interior designing works of the building had not been completed even at the end of the year under review.

### 3.3 Contract Administration

The following observations are made.

- (a) The scope of the works under the contract for construction of the building for Highways Secretariat with 03 levels which awarded in 2010 had been changed subsequently as a building consisted with 10 levels. As a result, the estimated construction cost of Rs.599.30 million in 2010 had been increased upto Rs.2,057.25 million as at 31 December 2016. The approval of the Cabinet of Ministers for such alterations of the works had been obtained only on 10 December 2015 to meet the costs, out of the allocation made by the Government of Sri Lanka. Although the defect liability period of the construction contract was ended on 10 September 2016, a separate contract had been awarded to a private Company on 07 July 2015 at an estimated cost of Rs.9.55 million to rectify the defects of the building. However, the

Consultant had not issued the completion report up to 30 May 2017 and the Project had released the retention money on 31 December 2016.

- (b) Further, the several items which were not included in the original Bill of Quantities 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 on the variation orders, allowing the contractor to claim additional charges up to 35 per cent on overhead, fixing charges and profits margins etc. Further, air conditioning system of the building procured and installed at a cost of Rs.218.93 million was not functioned properly even up to 30 May 2017. As a result, an additional cost of Rs.5.25 million had to be incurred to install extra 30 air conditioners.
- (c) The contract for supplying and fixing of partitioning and ceiling works, supply and fixing of furniture and timber works and interior finishing and flooring works had been awarded to 04 contractors at an estimated cost of Rs.241.60 million. However, costs agreed under 03 contracts had been subsequently increased by Rs.85.50 million and the extensions of time ranging from 147 to 154 days had been awarded.
- (d) The Contracts awarded for supplying and installation of mechanical and electrical works had been terminated due to the failures of the contractors, after being completed 55 per cents of the works valued at Rs.3.86 million.

#### **3.4 Idle Assets**

It was observed that the public addressing system procured at a cost of Rs. 6.47 million for the auditorium of the building had remained idle for over 02 years.