

Southern Road Connectivity Project - 2017

The audit of financial statements of the Southern Road Connectivity Project for the year ended 31 December 2017 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 Article iv Section 4.05 of Loan Agreement No. 3027 – SRI dated 27 May 2014 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 of the Project, then Ministry of Ports and Highways presently, the Ministry of Highways and Road Development is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve national transport efficiency by upgrading and rehabilitating 33 kilometres of the roads linked to the Southern Highway. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 95 million equivalent to Rs.12,248 million and out of that US\$ 70 million equivalent to Rs.9,025 million was agreed to be provided by the Asian Development Bank. The Project commenced its activities on 27 May 2014 and scheduled to be completed by 30 December 2018.

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 Donor 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 opening and closing balances, withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (f) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Sri Lanka Public Sector Accounting Standards.
- (i) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) 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 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 2017 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2017 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 opening and closing balance, withdrawals from and replenishments to the Special (Dollar) Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) 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 Agreement,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations were made.

- (a) The mobilization advance amounting to Rs.41.5 million recovered from the interim payment certificates presented in December 2017 had not been brought to the financial statements.

- (b) Retention money deducted from the interim payment certificates amounting to Rs.20.5 million and the value of work certified amounting to Rs.188.70 million as at 31 December 2017 had not been accounted and shown in the financial statements.

3. Financial and 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 2017 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		during the year 2017	up to 31 December 2017	US\$ million	Rs. million
ADB	70	9,025	1,515	10.25	1,473.52	22.04	3,222.47
GOSL	25	3,223	700	4.37	633.00	20.07	2,933.86
	<u>95</u>	<u>12,248</u>	<u>2,215</u>	<u>14.62</u>	<u>2,106.52</u>	<u>42.11</u>	<u>6,156.33</u>

The following observations are made.

- (a) According to the above information, out of total allocation of US\$ 70 million equivalent to Rs.9,025 million made by the Lending Agency, only a sum of US\$ 22.04 million equivalent to Rs.3,222.47 million representing 31 per cent of the total allocation had been utilized as at 31 December 2017 after lapse of 3 ½ years from the commencement of the activities of the Project. Further, a comprehensive detailed action plan highlighting financial and physical targets in monthly, quarterly, biannually etc. covering entire Project period with fixing responsibilities to achieve the targets within the period of the Project had not been prepared and implemented. Therefore, the progress of utilization of fund allocated was remained slow.
- (b) The detailed budget for the year under review based on the work schedule of the Project had not been prepared. Therefore, a sum of Rs.633 million had only been utilized, out of the allocation amounting to Rs.700 million made in the Budget Estimate of the Line Ministry for the year under review.

3.2 Physical Progress

According to the Project Agreement, the Project had taken actions to upgrade and improve 33 kilometres of 06 link roads of the Southern Expressway, under 04 Contract Packages. The following observations are made with regard to the physical progress of the road construction activities.

- (a) According to the progress reports, the improvement works of 2.50 kilometres of Moratuwa – Piliyandala Road and the improvement works of 2.14 kilometres of Rathmalana – Mirihana Road under Contract Package-01 had been completed at end of the year under review. However, the works under 235 items included in the Bills of Quantities valued at Rs.134 million had not been completed by the contractor. The rehabilitation works of 04 roads under other 03 Contract Packages had shown slow progress ranging from 08 per cent to 61 per cent at end of the year under review, due to the changes made to work schedules and poor performance of the contractors.
- (b) The works on relocating of electricity lines and telephone lines of the Kesbewa to Pokunuvita Road had shown slow progress, eventhough sums of Rs. 87.7 million and Rs. 44 million representing 68 per cent of the total allocation had been paid to the Ceylon Electricity Board and Sri Lanka Telecom respectively thereon. The re-fixing works of electricity poles and transformers had reported slow progress of period ranging from 69 days to 165 days whilst the re-fixing works of telephone posts and exchange boxes had remained with slow progress ranging from 102 days to 182 days.

3.2 Contract Administration

According to the information received, the rehabilitation works of 04 national roads under 04 Contract Packages had been awarded by the Project at the estimated cost of Rs. 6,417 million up to end of the year under review. The weaknesses in contract administration such as preparation of unrealistic and unreliable cost estimates, changes to construction plans, inaccuracies in designs, delays in handing over the sites, deviation from construction standards etc., were directly affected to the poor performance of the construction works. The following further observations are made in this regard.

- (a) As a result of unrealistic cost estimates of the rehabilitation works of Moratuwa – Piliyandala Road and Rathmalana - Mirihana Road under the Contract Package-01, the scope of works shown in the Original Bill of Quantities valued at Rs.1,322 million had been reduced subsequently. Therefore, the new estimated cost of the works had been determined as Rs.654 million. As a result, an overpayment on mobilization advances amounting to Rs.104 million had been made to the contractor and it was not recovered upto the date of completion of works as at 19 June 2017.
- (b) The following observations are made on contract of rehabilitation and improvements of Kesbewa to Pokunuwita Road and Kirulapona to Godagama Road awarded under the Contract Package-02.

- (i) The initial scope of the works under the rehabilitation and improvements of Kesbewa to Pokunuwita Road and Kirulapona to Godagama Road had been changed after entering into the contract agreement. Therefore, the overall length of the Roads had been reduced by 5.63 kilometres while reducing the length of the lanes by 1.52 kilometres. However, approval of the Technical Evaluation Committee and the Procurement Committee for the above scope changes had not been obtained by the Project.
 - (ii) According to the progress report for the month of December 2017, the contractor had submitted 13 variation orders for the approval of the Implementing Agency and out of that, 07 variation orders valued at Rs.255 million had been approved by the Project Director. It was observed that 02 of such variation orders valued at Rs.46 million on upgrading of culverts were remained out of the scope of the works of the contract.
 - (iii) It was observed that 05 additional bridges had been constructed under the variation orders valued at Rs.129.40 million without analyzing the rates quoted in the claims submitted by the contractor which remained higher than 23 per cent to 215 per cent compared with the rates included in the original Bill of Quantities.
 - (iv) It was observed that a sum of Rs.49 million had been paid in November 2017 to the contractor as temporally cash advances without considering the slow progress of the works of the contractor.
- (c) The following observations are made on the rehabilitation and improvements of the section of the Road from Southern Expressway to Madurugoda.
- (i) According to the initial Action Plan, the rehabilitation works of the Road was scheduled to be commenced in July 2015. However, the contracts thereon had been awarded in September 2016. Further, the Project had not carried out proper detailed engineering study before preparation of Bill of Quantities and as a result, quantities included in the initial Bill of Quantities had been increased from 05 per cent to 10,429 per cent as at 31 December 2017.
 - (ii) The Project had not accurately identified the required length of the section of the Road to be rehabilitated at the initial stages. Therefore, additional works of 358 metres of the Road had been subsequently allowed to carry out at higher rates.
 - (iii) According to the specific provisions under Part-B sub-clause 4.25 of the contract agreement, the contractor is responsible for relocation, removal and protection of public utilities and such works had been completed as at 31 December 2017 with delays ranging from 28 days to 151 days. It was revealed at the site visits that several electricity poles had been shifted from the site after completion of the asphalt laying works, affecting to the quality of the road works.

- (iv) Eventhough 56 quality tests on Aggregate Base Course of the Road is required to be carry out by the contractor to ensure the quality of the layer of Aggregate Base Course, only 33 quality tests had been carried out thereon. Thus, it was indicated that the quality assurance plan for the rehabilitation works had not been properly followed by contractor.
- (d) The following observations are made on the construction works of the section of the Ambatale Road.
 - (i) The simultaneous development works carried out by the Sri Lanka Land Reclamation Corporation had not been recognized at the initial stages and as a result, alignment of the road initially designed had been changed after 04 months of the date of commencement the construction. In addition, the Project had removed the rehabilitation works of the section from 0+000 kilometres 0+200 kilometres of the Road included in the initial scope of works.
 - (ii) According to the work designs, the width of 300 mm of 02 retaining walls constructed at the road side to be maintained. It was revealed at the physical site visits and measurements made thereon, the existing width of the retaining walls had remained between 280 mm to 290 mm.

3.3 Issues on Financial Controls

The commitment charges amounting to Rs.92 million had been recovered by the Lending Agency, due to slow progress of utilizing of the proceed of the Loan.

3.5 Land Acquisition and Resettlement Activities

According to the information made available, compensation aggregating Rs.2,818 million including the additional compensation aggregating Rs.782 million had been settled as at 31 December 2017 for 2,069 plots of land acquired by the Project on the recommendations made by the Land Acquisition and Resettlement Committees.