

National Highways Sector Project – 2017

The audit of the financial statements of the National Highways Sector Project (Additional Financing) 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 Section 2.09 of Article II of the Loan Agreement No. 2767 SRI dated 14 December 2011 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 Highways, presently the Ministry of Highways and Road Development of the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve the national transport efficiency by upgrading, rehabilitation and realignment of about 62 kilometres of national highways. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 105.60 million equivalent to Rs.13,728 million and out of that US\$ 85 million equivalent to Rs.11,050 million was agreed to be provided by the Asian Development Bank. This Project was implemented to provide additional finance for simultaneous Project called National Highways Sector Project which was completed on 11 September 2017. Eventhough these two projects are administered by the same Project Monitoring Unit, the financial statements for the year ended 31 December 2017 for respective Projects are submitted separately. The Project commenced its activities on 14 December 2011 and scheduled to be completed by 31 December 2015 and extended up to 31 December 2017.

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 as 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 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 are made.

- (a) A sum of Rs.1,281 million and Rs.237 million received in 2014 and 2017 respectively from the Road Development Authority to meet the costs on land acquisition had been shown in the financial statements as payable balances instead of being shown as the capital grants contributed by the Road Development Authority

- (b) The interest cost on land acquisition shown in the financial statements had been understated by Rs.869,382 due to erroneous accounting treatments.

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 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 during the year 2017 as at 31 December 2017			
	US\$ million	Rs. million		Rs. million	US\$ million	Rs. million	US\$ million
ADB	85.00	11,050	200.0	1.16	171.42	78.87	10,441.29
GOSL	20.60	2,678	84.5	0.57	84.15	39.43	5,220.21
Total	<u>105.60</u>	<u>13,728</u>	<u>284.5</u>	<u>1.73</u>	<u>255.57</u>	<u>118.30</u>	<u>15,661.50</u>

It was observed that allocation of US\$ 6.13 million equivalent to Rs.923 million representing 7.20 per cent of the total allocation made by the Lending Agency could not be utilized at the end of the period of the Project, due to slow progress on civil construction works and poor planning etc, and refunded to the Lending Agency on 11 September 2017.

3.2 Physical Progress

According to Project implementation Plan, it was scheduled to upgrade and rehabilitate of 62 kilometres of 02 roads directly linked to the Southern Expressway at Hikkaduwa and Aluthgama and other 04 roads of Matara - Godagama, Katukurunda -Nagoda, Nugegoda - Homagama and Pamankada - Kesbewa. However, the rehabilitation works of 55.31 kilometres of such roads had only been designed and completed even as at 31 December 2016.

3.3 Contract Administration

The following observations were made.

- (a) It was observed that the cost estimates prepared for 04 contracts had been increased ranging from Rs.4.56 million to Rs.283 million representing 0.71 per cent to 22.98 per cent than the cost of the contract awarded, due to inadequate attention on preparation of cost estimates.
- (b) It was observed that the rehabilitation and improvement works of the road from Matara to Godagama had been completed as targeted whilst other roads had been completed with delays ranging from 172 days to 338 days. Eventhough the Project had deducted delay charges thereon aggregating to Rs.128 million from the 03 contracts, it was refunded subsequently allowing time extensions thereon.
- (c) A sum of Rs.3.6 million had been allocated in the Bill of Quantities to remove trees by the sides of the roads and no allocation had been made for the replanting purposes to mitigate the environmental effects. Therefore, a sum of Rs.7.2 million had been spent as at 31 December 2017 to remove 1,620 trees with the girth between 300 mm to 2,000 mm located by the sides of the all roads. However, a sum of Rs.4.48 million had been spent during the year under review to replant 806 trees along the Pamankada to Kesbewa Road under a variation orders, at a higher cost ranging from Rs.4,000 to Rs.9,677 per plant.

3.4 Extraneous Activities

The Project had spent a sum of Rs.18.33 million for the acquisition of land for Galle-Baddegama Road which was not included in the original scope of the works of the Project.

3.5 Uneconomic Transaction

The Value Added Tax amounting to Rs.218 million had to be paid to the contractor up to 31 December 2017, as the Implementing Agency had not taken action at the initial stages to exempt the local taxes on payment to the contractors.

3.6 Land Acquisition

According to the information made available, it was scheduled to acquire 7,082 plots of land including 1,535 plots of land owned to the Government and out of that compensation amounting to Rs.1,933 million for 4,343 plots of land had been paid under the Section 17 of the Land Acquisition Act. Further, the additional payments amounting Rs. 4,134 million had been made thereon under the decisions of the Land Acquisition and Resettlement Committees. In addition, a sum of Rs.31 million had been paid as interest on delays in settlement of compensation up to 31 December 2017.

3.7 Closure of the Activities of the Project

Eventhough the activities of the Project had been closed as at 31 December 2017, necessary instructions had not been issued by the Executing Agency to hand over of the assets of the Project to the respective Implementing Agencies and prepare the financial statements for winding up purposes.