

China Development Bank Funded Priority Road Project 3 - (Phase II) - 2017

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase II) 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 Loan Facility Agreement No.4510201401100000587 dated 24 November 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank (CDB) Corporation.

1.2 Implementation, Objectives and Funding arrangement 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/rehabilitate existing national roads and rural roads providing crucial accessibility and quality of transport infrastructure and services to 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 was US\$ 117.66 million equivalent to Rs.15,594.14 million and out of that US\$ 100 million equivalent to Rs.13,253 million was agreed to be provided by the China Development Corporation of China.

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 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 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 and
- (h) 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 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 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 Non-Compliance with Laws, Rules and Regulations

The Board of Surveys for the year under review on assets remained at the site offices and laboratories of the Project had not been carried out, as enable to verify the existence of such assets as required by the Financial Regulation No.756.

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 Agreement		Allocation made in the budgeted estimate for the year under review	Fund utilization	
	US\$ million	Rs. million		During the year under review	As at 31 December 2017
	US\$ million	Rs. million	Rs. million	Rs. million	Rs. million
Lending Agency	100.00	13,253.00	5,900.00	4,917.09	7,111.06
GOSL	17.66	2,341.14	1,300.00	1,074.00	1,445.30
	<u>117.66</u>	<u>15,594.14</u>	<u>7,200.00</u>	<u>5,991.09</u>	<u>8,556.36</u>

3.2 Physical Progress

According to the information received, it was planned to rehabilitated 128.85 kilometers of 20 national roads during the period of the Project. However, the physical progress ranging from 47.10 per cent to 77 per cent had been achieved as at 31 December 2017 against the expected target of 80.60 per cent to be achieved as at that date.

3.3 Contract Administration

The following observations are made.

- a) It was observed that the allocations for the provisional sums and contingencies etc made in the Bill of Quantities had been considered by the Project for the calculation of mobilization advances to the contractors, contrary to the paragraph 5.4.4 (1) of the Government Procurement Guideline. As a result, a sum of Rs.757 million had been overpaid thereon to the contractors as at 31 December 2017.
- b) The rehabilitation works of Medawala-Hediniya Road and Pussellagama-Ulpotha Road in the Central Province had been carried out even though the rehabilitation works of the respective roads were not included in the original scope of the works and sums of Rs. 295 million and Rs.172.2 million respectively had been spent under variation orders as at 31 December 2017. Further, the approval from the respective parties had not been obtained for the above mentioned variations of the scope of works.
- c) The rehabilitation works of 1.75 kilometers of Rajapeella Mawatha in Kandy in the Central Province included in the original work plans of the Project to be carried out at an estimated cost of Rs.245 million had been suspended subsequently and instead of that the rehabilitation works of a kilometre of A.S.B.Hameed Mawatha in Kandy in the Central Province had been carried out at a cost of Rs.245 million.
- d) It was observed that the users of the newly reconstructed road with the length of 11 kilometres from Nawalapitiya to Nagaswella could not reach the optimum benefits of the investment, as the construction works of the road was completed only up to Nagaswella Bridge, without being connected to the adjoining town of Yatiyanthota. The reasons for curtailment of the reconstruction works of road was not explained for audit.

3.4 Matters in Contentious Nature

The following observations are made.

- (a) It was observed that the rates included in the Bill of Quantities for the rehabilitation of roads under the Project was remained high when compared with the rates applied for the rehabilitation works carried out by other Donor Funded Projects in the area. The rates for removing of trees applied in the Bill of Quantities for the road rehabilitation works carried out in the Central Province had remained from Rs. 13,500 to Rs 40,000 per unit , whilst the rates ranging from Rs.5,660 to Rs. 15,470 per unit applied for the similar rehabilitations works carried out by other Donor Funded Project at Peradeniya - Badulla-Chenkaladi Road in the Central Province. Further, a sum of Rs 592,780 had been allocated for the purpose of control and management of road safety and temporary division of traffic etc of the roads concerned whilst only a sum of Rs.207,297 had been allocated for the same works of the sections of Peradeniya - Badulla-Chenkaladi Road.

- (b) The core sample taken at site inspection made by the auditors on 04 April 2018 at 6+950 kilometer of Katugasthota-Medawela Road had remained at an average thickness of 37.5 mm, contrary to the standard thickness of 50 mm. Thus, the controls over the ensuring the quality of the works and roadworthiness of the rehabilitated sections of the Road had remained doubtful in audit.
- (c) The Road Development Authority had assigned 03 Consultants for social and environmental compliance and land acquisition work purposes of the Project at a monthly remuneration of Rs 65,000 since July 2017. However, land acquisition works, had not been carried out by the Project during the year under review.
- (d) According to the section 4.2 of the general conditions of the Contracts Agreement , the cost of the performance bond should be borne by the contractor at his own cost. However, a sum of Rs 6.98 million had been spent by the Project during the year under review , out of the proceeds of the Loan as the cost of performance bond for the contractors engaged in rehabilitation works of 20 national roads.