

Road Sector Assistance Project - 2018

The audit of the financial statements of the Road Sector Assistance Project for the year ended 31 December 2018 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 4.01(b) of Article IV of the Development Credit Agreement No.4138- CE dated 16 January 2006 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. My comments and observations which I consider should be reported to Parliament appear in this report

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Development Credit Agreement, then Ministry of Higher Education and Highways, presently the Ministry of Roads and Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to lower transportation cost through sustainable delivery of an efficient national road system. As per the initial Development Credit Agreement, the estimated total cost of the Project was SDR 69.10 million (US\$ 100 million) equivalent to Rs.10,125 million and the entire amount was agreed to be financed by the International Development Association. Further, an additional allocation of SDR 59.60 million (US\$ 98.1 million) equivalent to Rs.11,579 million had been provided under the First Supplementary Development Credit Agreement of 23 June 2008. The Second Supplementary Development Credit Agreement had been entered on 15 March 2011 and an additional allocation of SDR 63.6 million (US\$ 100 million) equivalent to Rs.11,081 million had been made thereon. Initially, the Project commenced its activities on 16 January 2006 and scheduled to be completed by 31 March 2011. Further, the period of Project had been extended up to 30 June 2015. However, the operations of the Project had been continued and the financial statements for the year ended 31 December 2018 had been prepared and presented for audit.

1.3 Opinion

In my opinion, except for the effects of the matters described in the Table 2.1 of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2018, financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.4 Basis for Qualified Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of Management and those charged with governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal

control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Projects ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters,

significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Comments on Financial Statements

2.1 Accounting Deficiencies

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
Although the rehabilitation and reconstruction works of national and rural roads carried out by the Project had been completed and the activities of the Project had been closed as at 31 December 2016, necessary instructions had not been issued by the Executing Agency to wind up the operations of the Project due to dispute on settlement of claims made on the rehabilitation works of Galle- Deniyaya Road and Ingiriya – Ratnapura Road which remained unsettled even as at 31 December 2018. As a result, the financial statements for the year under review had been prepared on going concern basis without being considered to transfer the responsibility to the Road Development Authority to settle disputes referred to the Dispute Adjudication Boards.	Misapplication of accounting policies	Not responded.	Action need to be taken to wind up the operations of the Project Monitoring Unit and prepare the financial statements accordingly.

3. Physical Performance

3.1 Physical progress of the activities of the Project

According to the information received, the rehabilitation and maintenance work of 620 kilometres of national roads in 08 Provinces and 635 kilometres of provincial and rural roads under purview of 03 Provincial Councils and 09 Pradeshiya Sabhas were expected to be implemented by the Project. However, the rehabilitation works of 685 kilometres of national roads and 162 kilometres of provincial and rural roads had been completed as at 30 June 2015. The following observations are made.

Audit Issue	Impact	Response of the Management	Auditor's Recommendations
(a) It was observed that a sum of Rs.733.87 million had been claimed by the contractor involved in rehabilitation works of Ingiriya – Ratnapura Road for the extension of time and costs incurred on prolongation, acceleration and other purposes. In addition to that, a sum of Rs.841.98 million had been claimed by the contractor for the interest cost. According to the information received, the Cabinet of Ministers had decided at its meeting held on 10 October 2019 to pay a sum of Rs.1,000 million to the respective contractor and settle the claims.	Possibility to incur additional costs.	The decision had been taken on the award granted in February 2018, in favor of the contractors after 9 years of the arbitration proceeding commenced and action will be taken to submit an appeal against the decision, as advices by the Department of the Attorney General.	Need to explore the possibilities to settle the dispute with minimum costs to the country. Action should be taken to explore the reasons to make extra claims by the contractor.
(b) It was observed that the disputes on settlement of payments on rehabilitation and improvement of Galle – Deniyaya Road had been arisen as the Road Development Authority was not agreed with the decision of Dispute Adjudication Board to pay a sum of Rs.67.69 million and US\$ 858.017 to the contractor. The dispute had been referred to the Amicable Settlement Committee and not settled even as at 31 December 2018.	-Do -	The Amicable Settlement Committee submitted their report to the Ministry of Highways to date no action had been taken to obtain Cabinet Approval to make this payment.	Action should be taken to minimize the loss.
(c) It was observed that compensation amounting to Rs.23 million had been paid during the year under review to 87 persons on damages made to houses and buildings, due to reconstruction works of Kantale – Trincomalee Road completed in 2013. Further, an allocation amounting to of Rs.5 million had been made under the pay item No 119(2) of the Bill of Quantities and	Possibility of unauthorized payments.	End of the period of reconstruction and during the defect liability period, the Project received 88 complaints from the owners of houses and commercial buildings located along both sides of the road, stating that the buildings have been cracked due to road construction works. The	Damages to the houses and building were required to be rectified within the defect liability period at a cost of the contractor.

paid to the contractor to obtain the insurance coverage to meet the cost on damages of the properties at the road side and it evidenced that the responsibility on payment of compensation on damages was rested with the contractor.

Road Development Authority had made a request to National Building Research Organization to carry out an investigation and the final report thereon had been submitted with recommendations on 17 April 2014.

- (d) It was observed that the rehabilitation and maintenance work of 11 roads had been completed with delays over a year whilst delays over 200 days of rehabilitation of other 05 roads. Further, the estimated costs of the rehabilitation works of said roads aggregating Rs.14,816 million had been increased up to Rs.22,065 million representing 48.92 per cent of the estimated cost at the time of completion of works, due to scope changes, variations and additional works etc.
- The delay in construction works affected to increase the Project cost and receiving benefits to the indented beneficiaries of the Project.
- In a road construction projects there may be delays, variations and the project completion and period extended etc, due to several reasons such as preparation of initial estimates based on preliminary survey and using typical drawings. During detailed design and construction, the designs, quantities and the scope are changed to suit actual sub soil conditions.
- The scope of works of the Project should be properly planned to complete them on target dates.