

China Development Bank Funded Priority Road Project 3 - (Phase II) - 2018

The audit of financial statements of the China Development Bank Funded Priority Road Project 3 - (Phase II) 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 provisions in the Loan Agreement No.4510201401100000587 dated 24 November 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the China Development Bank Corporation (CDB). My comments and observations which I consider should be reported to the Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Program

According to the Loan Agreement, then Ministry of Ports and Highways, presently the Ministry of Roads and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objectives of the Project are to rehabilitate and improve 131.50 km of 09 road sections in the Central, Eastern, Sabaragamuwa, Western and North Western Provinces. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 81.75 million equivalent to Rs.10,628 million and out of that US\$ 60 million equivalent to Rs.7,800 million was agreed to be financed by Saudi Fund for Development. The Project commenced its activities on 03 June 2013 and scheduled to be completed by 31 December 2018.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2018, and of its cash flow statement for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.4 Basis for 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.

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

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 the Project’s internal control.
- 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 Non-Compliance with Laws, Rules and Regulations

No	Reference to the Rules and Regulations	Non-compliances	Impacts	Responses of the Management	Auditor’s Recommendation
-----	-----	-----	-----	-----	-----
(a)	Public Finance Circular No	Verification of inventories had not been	of Weaken internal	All the verified details and schedules now	Circular Instructions

- 05/2016 and conducted and control available at the project should be
Financial verification reports were system. office. followed.
Regulation not forwarded to the
No.756. Auditor General.
- (b) National An action plan had not Weaken Scheduled format of the Circular
Budget been prepared in order to internal plan has been changed Instructions
Circular No identify individual output control time to time with the should be
06/2015 dated on their delegated duties. system. requirement of the followed.
29 December Further, the key Planning Division of
2015 performance indicators and a critical path for smooth function of the Project activities had not been prepared for the year 2018.
- (c) Financial The Fixed Assets Register Difficult Verification was done Circular
Regulation related to Project to for the period ending 31 Instructions
No.751 of the Management Unit and identify December 2018 for site should be
Democratic project offices had not the loss of office & laboratories. followed.
Socialist been maintained by the of All the verification
Republic of project in an updated assets. schedules available at
Sri Lanka. manner. PD's office

3. Physical Performance

3.1 Physical progress of the activities of the Project

Audit observation	Impact	Responses of the Management	Auditor's Recommendation
-----	-----	-----	-----
According to the initial plan, the rehabilitation works of 128.10 Kilometers of 20 National Roads scheduled to be carried out within the Project period. However, according to the progress report, out of 20 National Roads more than 80 per cent of 11 roads and more than 75 per cent of 5 roads had been completed as at 01 January	Possibility to incur unnecessary expenditure by the project.	During the year 2017, achieved the progress as 80 per cent. Employed the staff in 2017 with the requirement of the ongoing activities of the project. But the year 2018 was the peak of the construction activities and we have to employ balance all staff to the project as per the approved cadre.	Action should be taken to speed up the balance rehabilitation of roads works.

2018. In this regard the expenditure of the Project Management Unit had been increased by Rs.45 million or 81 per cent compared with previous year, the reasons for increasing the expenditure was not made available to audit.

3.2 Contract Administration

The following observations are made.

No	Audit Issue	Impact	Responses of the Management	Auditor's Recommendation
	-----	-----	-----	-----
(a).	Though the contractor shall obtain a performance security at his own cost for the proper performance of the contract as per the sub clause 4.2 General Condition of the Contract, it was observed that the Project had included a separate pay item in the Bill of Quantities, by allowing contractors to claim for cost of providing performance guarantees which should be borne by the contractor at his own cost. Accordingly, a sum of Rs.15 million had been paid to the contractors under pay item 108.1(1) as an extraneous payment.	Undue advantage for contractors.	If didn't include this item, contractor may include this cost in other rates and resulting in rate may goes up. Therefore, payment may under the available provision in the BOQ with pay item 108.1(1) is not and extraneous payment.	Action should be taken to recover the over payment.
(b).	The Road Development Authority had assigned consultant for social and environment compliance and land acquisition work at a monthly remuneration of Rs.65,000. Even though a sum of Rs. 447,500 had been paid to the consultant up to 31 July 2018, land acquisition works had not been carried out by the Project during the year under review.	Possible increase of cost due to unnecessary staff deployment.	This project is not considered land acquisition process. Additional lands for road widening of this project were considered with donated basis of respective land owners. For this aim, Lengthy discussions have to be done with several parties and consultants	Action should be taken to reduce unnecessary staff deployment.

assigned to the project
were given their
contribution and co-
ordinate the area
political arm positively
to get the consent of the
land owners.