

China Development Bank Funded Priority Road Project III (Phase I) - 2020

The audit of financial statements of the China Development Bank Funded Priority Road Project III (Phase I) for the year ended 31 December 2020 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. 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 Project

According to the Loan Agreement, then Ministry of Higher Education and Highways, presently the Ministry of Transport and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve mobility of National Highway Network of the country through the rehabilitation of sections of road selected on a priority basis spread throughout the country thereby facilitating access to contribute to economic development activities. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 357.69 million equivalent to Rs.46,184.54 million and out of that US\$ 300 million equivalent to Rs.38,736 million was agreed to be financed by China Development Bank. The Project commenced its activities on 09 September 2014 and scheduled to be completed by 17 June 2017. However, the completion date of the activities of the project had been extended up to 31 December 2020.

1.3 Qualified 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 2020 and of its cash flows 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 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 Deficiency

Accounting Deficiency

Response of the Management

Auditor's Recommendation

The exchange differences amounting to Rs.405 million arisen in foreign operations had not been recognized under net assets of the project in accordance with the paragraph 36 of Sri Lanka Public Sector Accounting Standard No. 05.

Action will be taken to record the exchange rate differences under the net assets as per the Sri Lanka Public Sector Accounting Standard No.05.

Exchange differences arisen in foreign operations need to be recognized as per the Sri Lanka Public Sector Accounting Standard No.05.

3. Physical Performance

3.1 Physical Progress of the activities of the Project

Audit Issue	Response of the Management	Auditor's Recommendation
<p>According to the work plan of the Project, rehabilitation works of 248.49 km of 12 roads in Sabaragamuwa, Southern, Central and North Western province were expected to be carried out by the Project and the contracts for rehabilitation works had been awarded to 03 foreign contractors. The rehabilitation works of 12 roads only 248.34 km and other 15 roads only 72.45 km from variation orders had been completed as at 31 December 2020.</p>	Noted.	<p>Action should be taken to speed up the balance rehabilitation of roads works.</p>

3.2 Contract Administration

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	<p>It was observed that 22 taking over certificates had been issued without obtaining conditions of the completion of snag list of work as per the Section 10.1 of the Particular Conditions of the Contract.</p>	<p>All the snag lists have been completed by now.</p>	<p>Need to adhere the conditions of the Contracts.</p>
(b)	<p>The separate pay items had been made in the Bill of Quantities on road rehabilitation works by allowing contractors to quote the cost of providing performance guarantees, contrary to the provisions made under the sub clause 4.2 of the General Condition of the Contract to obtain performance security bonds at cost of respective contractor. Accordingly, a sum of Rs. 96.4 million had been paid additionally to the contractors to reimburse the cost of performance security bonds related to C1, C8, C4, C9 and C10 contract packages.</p>	<p>Otherwise, contractors add the cost of the performance security to other pay items resulting in rate increases while the employer incurs the cost ultimately.</p>	<p>The review of Bill of Quantities needed to be done by the Procurement Specialist and the Technical Evaluation Committee, before issuing the bidding documents.</p>

- (c) Contrary to Sub Clause 14.9 of General Conditions of Contract, Rs. 46.4 million had been paid as retention money related to 4 construction works before the expiry date of defect notification period under a Bank guarantee.
- The defect liability period of 4 projects were to be expired in 2021. But, there was no any account to retain the second half of the retention money which are to be released at the end of the Defect Liability Period. Therefore, it was the only option to close the loan by the date insisted by treasury was to release the retention with a bank guarantee.
- Need to adhere the conditions of the Contracts.