

Badulla - Chenkaladi Road Improvement Project - 2022

The audit of financial statements of the Badulla - Chenkaladi Road Improvement Project for the year ended 31 December 2022 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 Parliament appear in this report

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, the Ministry of Transport and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project.

The objectives of the Project is to improve the connectivity of Eastern Province with Uva Province and Central Province enabling the improvement of transportation and enhancing the economic activities in the region by rehabilitation of 147 kilometres of the road Badulla to Chankaladi of Peradeniya-Badulla-Chenkaladi Road.

As per the Loan Agreement, the estimated total cost of the Project was US\$ 140 million equivalent to Rs. 18,200 million and out of that US\$ 60 million equivalent to Rs. 7,800 million was agreed to be financed by OPEC Fund for International Development and US\$ 60 million equivalent to Rs. 7,800 million was agreed to be finance by the Saudhi Fund for Development. The balance of US \$ 20 million is expected to be financed by the Government of Sri Lanka.

The Project had commenced its activities on 12 January 2017 and scheduled to be completed by 30 June 2021. However, the date of completion of the activities of the Project had been extended up to 31 December 2025.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion section of my report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2022 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.

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 scepticism 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

No	Accounting Deficiency / Audit Issue	Amount Rs. Million	Response of the Management	Auditor's Recommendations
(a)	Loan balance of the OFID Fund and SFD Fund had been shown in the statements of financial position could not be verified in audit due to non-availability of records of Donor Agency.	6,905.83 (OFID) 6,347.42 (SFD)	Confirmations from the loan balances had been requested from the donors through ERD. However, the disbursement balances sent by the External Resources Department had been submitted for the audit.	Loan conformations should be obtained from the donor.

(b) Interest charge had not been accounted in the financial statements as at 31 December 2022. As a result, foreign loan balance and work in progress in the financial statements had been understated by that amount.	371.20	The interest charge associated with the loan repayment has not been incurred as a component of the Loan amount granted and this is incurred by the Treasury. This financing charge is paid by the Treasury, without charging to the project expenditure vote.	Interest charges should be accounted.
(c) As per the Section 18 of Sri Lanka Public Sector Accounting Standard – 04, borrowing cost that are directly attributable to the acquisition, construction or production of assets should be capitalized as part of the cost of that assets. However, the Project had not capitalized borrowing cost relevant to the RDA loan as at 31 December 2022.	2.54	Project has recorded funds received from RDA loan under equity since it is a loan obtained by RDA and not by the project. Therefore, interest and capital repayments are recorded at their end. However, the borrowing cost will be capitalized to the asset once the asset is transferred to the RDA.	Adhere to the Sri Lanka Public Sector Accounting Standards.
(d) The compensation on land acquisition relevant to 05 lots of land had not been shown in the financial statements as at 31 December 2022. As a result liabilities in the financial statements had been understated by that amount.	0.80	Once the valuation reports are received by the DS, Section 17 decision is issued to obtain the consent for compensation from the land owner. Then only the DS sends the certified compensation vouchers for payment to the project office. Although the valuation related to these 5 lots was received before 31.12.2022, the related certified vouchers we received by the project office in January and February 2023. Hence, it was not reported under year of 2022 because the compensation is paid after the certification of the Divisional Secretary.	Compensation payable should be accounted as liability.
(e) Even though the delayed interest for 780 lots of land and compensation for 3339 lots of land should be payable as at 31 December 2022, a provision had not been made in the financial statements. As a result, liabilities in final statement had been understated by that amount.	15.96	The information provided by the land division is an estimate collected from the Divisional Secretaries, which have not certified and to be submitted the project office. As these vouchers are not duly certified by the DS, such amounts had not been taken into accounts under review.	Provisions should be made in the financial statements.

2.2 Unreconciled Balances

Value as per Financial Statements Rs. million	Value as per corresponding records Rs. million	Description of the corresponding record	Response of the Management	Auditor's Recommendations
496.52	496.58	Schedules submitted by the Land Division of the PMU.	Land Division maintains a separate database which is different from the accounts division. However, a mechanism will be implemented in future to maintain a common database.	The balances in the financial statements should be reconciled with the source documents.

2.3 Non Compliance with Laws, Rules and Regulations

Reference to the Laws Rules and Regulations	Non Compliance/Audit Issue	Response of the Management	Auditor's Recommendations
Management Service Circular No. 01/2019 dated 05 March 2019. Section 9.3	The Steering Committee of the Project should be met at least once in two months. However, the Steering Committee meetings had not been held during the year under review.	Once the projects are commenced operations with the announcement of lifting of social distance requirement and normalcy of the work, the PSC are progressing.	Adhere to the Circular instructions.

3. Physical Performance

3.1 Physical progress of the activities of the Project

(i) Road Rehabilitation

Component	Activity	As at 31 December 2022		Delay/ Audit Issue	Reasons for delays
		Expected physical performance percentage	Performance achieved Percentage		
Road rehabilitation	Lunugala – Bibile Highway	100	60	The contract had been abundant on 29 June 2021 due to inability to complete the contract within the agreed time frame.	Poor performance of the contractor.

Response of the Management The Employer did not issue the termination because the slow progress of the work was due to the difficulty of the road section with hilly terrain and hard work excavation. Procurement of blasting material for contractor was severe issue after the Easter Attack.

Auditor's Recommendations Adhere to the conditions of the contract.

(ii) **Land Acquisition**

Component	Activity	As at 31 December 2022		Delay/ Audit Issue	Reasons for delays
		Expected physical performance No. of plots	Performance achieved No. of plots		
Land Acquisition	Registration of ownership	5424	133	5,424 plots of lands had been acquired by the project. The compensation of Rs. 496.58 million for 2,085 plots of lands and delayed interest of Rs. 10.9 million for 326 plots of lands had been paid as at 31 December 2022.	Inefficacy in land acquisition process and lack of funding.

Response of the Management Land registration was done only for completed lots after payment of compensation and interest and then only registered under section 44.

Auditor's Recommendations Maximum effort should be taken to complete the land acquisition to avoid additional cost.

3.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The rehabilitation and improvement Lunugala to Bibile highway (OFID -03 Section) had been awarded to the contractor on 12 June 2017 for Rs. 2006.43 million. The contract period was 30 months. The original completion date of the construction was 25 January 2020 and it was extended up to 19 June 2021. The contract had been closed on 29 June 2021 due to poor performance and inability to complete the contract within the agreed time. The following observations are made.		

- (i) The performance guarantee provided by the contractor had expired on 31 July 2022. but, the employer had not taken any action to terminate the contract before the expiry of performance guarantee. As a result, the RDA as the employer to the contract had lost its opportunity to claim on the performance guarantee for the breach of contract by the contractor.
- e Employer did not issue the termination because the slow progress of the work was due to the difficulty of the road section with hilly terrain and hard work excavation. Procurement of blasting material for contractor was severe issue after the Easter Attack. Then the Employer tried to complete the project by negotiating with the Contractor and recommended to mutual termination with the consent of the Contractor after recover the advance payment made to contractor.
- Adhere to the conditions of the contract.
- (ii) According to the letter No.RDA/LD/BCRIP dated 05 August 2022 of the Director Legal of Road Development Authority, the contract has come to an end by 29 June 2021 at the rate of 60 per cent of physical progress. However, it was observed that RDA had sought the opinion of the Attorney General's Department on the closing of the contract with mutual agreement of the contractor and the employer by the letter dated 04 August 2022 after one year from the extended date of completion and even after the expiry of the performance guarantee provided by the contractor.
- The committee appointed for this matter given their recommendation to amicably mutually terminate the contract. Therefore both parties agreed to close contract mutually. Then there was no requirement to claim through the performance guarantee.
- Adhere to the conditions of the contract.
- (iii) The RDA has taken action to re-bid the contract package (OFID 03) by splitting in to two contract packages and those contracts had been re – awarded on 01 December 2022 before finalizing the terminating procedure of the existing contract. The legal basis for entering in to such new agreements was not revealed to audit. Further, it was observed that there is a risk of exercising legal action by the earlier contractor since the existing contract is not terminated.
- Both parties act in good faith to conclude contract mutually there was no any disputed matters. Hence, there is no risk of entering in to contract. The Contract commencement date was on 01 December 2022 and the contracts awarded in November 2022 after the Donor Concurrence and the Board approval.
- Adhere to the conditions of the contract.

(iv) As per the letter dated 17 November 2022 of the Attorney General's Department, RDA should act within the provisions of the contract but RDA had failed to act accordingly and the termination process had not been completed even as at the audited date of 14 August 2023. It was observed that, as a result there is a uncertainty in recovery the mobilization advance amount to Rs.208.67 million.

The best option available to employer to go for the mutual termination to avoid any time consuming and costly litigation work after agreeing with contractor and recovered all the advance paid to contractor.

Adhere to the conditions of the contract.

(b) Actions had not been taken to obtain VAT and NBT exemptions for contracts from the Department of Inland Revenue. As a result, Project cost had been increased due to VAT and NBT payment Rs. 680.99 million as at 31 December 2022.

VAT exemptions were requested for the civil works contracts from the Department of Fiscal Policies and not granted the exemptions as the project was not categorized as a special project.

Adhere to the conditions of the relevant Acts.

3.3 Underutilized Resources

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The Project had utilized only Rs. 16,881.86 million as at 31 December 2022 out of the total allocation of Rs.18,200 million equivalent to US\$ 140 million after laps of 6 years. Hence, it was observed that 7.2 per cent equalling Rs.1,318.14 million had remained as at 31 December 2022.	Mainly the loan savings are due to the depreciation of the rupee value against the USD and project savings.	Project funds should be utilized effectively.
(b)	Fund allocation for the year under review was Rs. 2,625 million, but the Project had only utilized of Rs.1,163 million during the year under review. Poor performance of the OFID 3 package was mainly affect to that situation.	Even though it was planned to construct the balance work of OFID 03 from April 2022, the Donor Concurrence had delayed up to October 2022 because of the announcement of the bankruptcy of the country.	Project funds should be utilized effectively.