

Second Integrated Road Investment Program (i-Road II) - 2022

The audit of financial statements of the Second Integrated Road Investment Program (i-Road II) 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 read in conjunction with Section 4.03 of Article IV of the Loan Agreements No. 3579 SRI and No.3580 SRI (COL) dated 22 November 2017 and Loan Agreement No.3851 SRI dated 13 November 2019 and No. 4067 SRI dated 28 May 2021 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. 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 Program

According to the Loan Agreements of the Program, the Ministry of Higher Education & Highways, presently the Ministry of Transport and Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Program. The objective of the Program is to enhance the road accessibility between rural communities and socio economics centres. The long term impact is to increase transport efficiency of national and provincial roads. As per the Loan Agreements, the estimated total cost of the Program was US\$ 1,084.60 million equivalent to Rs. 165,185 million and out of that US\$ 900 million equivalent to Rs. 137,070 million was agreed to be financed by Asian Development Bank. The balance amount of US\$ 184.6 million equivalent to Rs.28,115 million is expected to be financed by the Government of Sri Lanka. The financing plan of the Program consists five Tranches under Multitranche Financial Facility and out of that first three Tranche agreements amounted to US\$ 500 million had been signed with the donor as at 31 December 2022. The Program had commenced its activities on 20 July 2018 and scheduled to be completed by 31 March 2027.

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 Program 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.

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 Program’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 Accounting Deficiencies

Accounting Deficiencies	Amount Rs.	Response of the Management	Auditor’s Recommendation
(a) Although the Program had capitalized the cost of 09 completed road packages amounting to Rs.18,569.76 million as at 31 December 2022, a sum of Rs.129.77 million should be paid further to the particular contractors for 08 packages out of those 09 packages. Therefore the cost of completed roads had been understated by that amount.	129.77	The entries will be passed to the respective accounts.	Cost of the completed roads should be capitalized.

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| (b) | Contrary to the Sri Lanka Public Sector Accounting Standard No.8, provision had not been made in the financial statements for the doubtful recoveries on mobilization advances and performance guarantees amounting to Rs.1,250.88 million from the contractors whose contracts were terminated. Further, it was also revealed that the contractors had taken court actions against those recoveries. | 1,251 | Contractors had taken court orders preventing the encashment of guarantees. | Adhere to Sri Lanka Public Sector Accounting Standards. |
| (c) | The entire building rent amounting to Rs.18.32 million for the year under review on the Program Management Unit of i-Road and i-Road 2 had been charged to the iRoad Program without being apportioned proportionately to each unit. | 18.32 | According to the PAM, it is not possible to apportion part of its expenditure to the iRoad II Program. | Expenditure should be fairly apportioned among the programs. |

2.2 Non-compliance with Laws, Rules and Regulations

No	Reference to the Laws, Rules and Regulations	Non- Compliances	Responses of the Management	Auditor's Recommendations
(a)	Sub Clause 14.6 of the Particular Condition of Contract	The minimum amount of Interim Payment Certificate to be submitted by the contractor was 1.5 per cent of the accepted Contract value. However, 326 Interim Payment Certificates below than the required threshold amounting to Rs. 5,192.39 million under 58 packages had been paid to the contractors during the year under review.	Taking into consideration the difficult situations in the country, the consultant (Engineer) had been advised to process monthly payment certificates even if the payment values were below the limit.	Adhere with the thresholds stipulated in the condition of contract.
(b)	Sub Clause 14.7 and 14.8 of General Condition of the Contract	Although the employer shall pay the amount certified in each IPC within 56 days, it was observed that delays ranging from 01 to 90 days in 90 IPC payments amounting to Rs.2,102.71 million during the year under review. It was further observed that the contractor shall be entitled to receive financial charges on the unpaid amount during the period of delay.	The Contractor's submission may have some document discrepancies and incompleteness. This will make delay beyond 56 days.	Adhere to the condition of contract.

- (c) Sub Clause 4.2 of the General Condition of the Contract
- Although the Performance Securities should be provided by the contactors at their own cost as per Sub Clause 4.2 of the General Condition of the Contract, it was observed that a separate pay item had been made in the BOQs under Preliminary and General Items to be able to claim to the contractors. Accordingly, a sum of Rs.85.64 million had been paid to the contractors in Uva Province to reimburse the cost of Performance Securities as at 31 December 2022.
- If the provision was not provided the cost of the guarantee and other general expenses could have been included under BOQ items.
- Adhere to the condition of contract.
- (d) Public Contract Act No.3 of 1987.
- The bidders of public contracts which value over Rs.5 million should register under Public Contract Act before collecting the Bidding Documents and also should get the contract registration after the contract is awarded. It was observed that the Project had not considered that requirement when evaluating the technical bids of respective bidders.
- The contractors had been selected as per the ADB requirements from contracting companies registered in ADB member countries and not blacklisted by ADB.
- The bidders and awarded contract should be registered under Public Contract Act.

3. Physical Performance

3.1 Physical progress of the activities of the Program

Component	Activity	As at 31 December 2022		Delay/Audit Issue	Reasons for delays
		Expected physical performance (%)	Performance achieved (%)		
Completion of National rehabilitation works of National and Rural roads.	National and rural roads	89.35	66.95	(a) Although 417.75 km of national roads and 3338.87 km of 1349 rural were expected to be rehabilitated according to the Facility Administration Manual, rehabilitation works of 153.74 km of 13 national roads and 1,432.42 km of 557 rural roads had only been completed and handover to the respective agencies.	Inefficient contract management, fuel restriction and material shortages.

- (b) The original contract period of 720 days for the rural roads lapsed over the period ranging from 444 days to 530 days of the road rehabilitation works of Uva, Northern and Eastern Provinces of the Program.

Response of the Management

The temporary suspension of civil work announced in the last quarter 2022, had limited the completion percentages to this level.

Response of the Auditor

Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost.

3.2 Contract Administration

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(i)	Extension of Time (EOT) of the Contracts		
(a)	Out of 53 packages including 03 terminated packages for rehabilitation of rural roads in 04 provinces, the contract period had been extended to 46 packages. Further, it was observed that the EOT had been given for those packages on several occasions ranging from 1 to 30 times.	The travel restrictions imposed on COVID 19 pandemic situation was directly affected to approve the Extension of Time to contractors from time to time.	Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost.
(b)	It was observed that the extension of time had been given ranged from 57 to 684 days and it represented 8 per cent to 94 per cent of the initial contract period (730 days) of Uva, Northern and Eastern provinces. Further, the extension of time had been given ranged from 58 days to 164 days in Western Province representing 6 per cent to 18 per cent of the initial contract period of 912 days.	The travel restrictions imposed on COVID 19 pandemic situation was directly affected to approve the Extension of Time to contractors from time to time.	Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost.
(c)	The Program had given time extensions repeatedly even without getting approval for the early EOTs.	Extensions have been given for definite reasons up on the request of the contractor and the recommendations of the Engineering consultant.	Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost.

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| (d) | According to the details furnished to the audit, although the date of time extensions of the contract packages had lapsed over 18 months from the completion date, action had not been taken to grant further extension and the delay damages amounting to Rs.81.99 million had been charged only from 05 contract packages contrary to Section 8.7 of the General Conditions of the contract. | After checking the validity of consultant recommended request of the contractor, a recommendation will be obtained from the Technical Evaluation Committee at the Ministry level. | Adhere to the condition of contract. |
| (e) | It was revealed that abnormal time delays had taken to obtain the comment of the Secretary of the Line Ministry for the extension of time of the construction and action had not been taken to expedite the process. | An EOT application has to be gone through several levels for obtain approval and it is time consuming. | Action should be taken to expedite EOT process. |
| (ii) | Terminated Packages | | |
| (a) | Although the engineer should determine the value of the works, goods and any other sums due to the contractors as soon as practicable after issuing a notice of termination as per Section 15.3 of the General Condition of the contract, it had been prepared by the engineer after the lapse of 09 to 14 months period. Further, action had been taken by the Program to rebid those contracts on 12 May 2021 before calculating the value of termination contrary to the Section 15.3 of the General Condition of Contracts. So the reliability of the engineering estimates of balance works had been prepared for rebidded packages without consider the completed works of the terminated contractors was a problematic issue in audit. | While valuation was in process the project has taken steps to invite rebids to complete the balance work to minimize further cost increases on delays and avoid public complains and public inconveniences. | Adhere to the general condition of contract. |
| (b) | It was observed that the engineer had not evaluated the materials at the site immediately after the termination of the contracts as per Section 15.3 of the General condition of the Contract. | The contractor has not submitted jointly inspected documents to evaluate the materials at site. | Adhere to the general condition of contract. |
| (c) | Instead of the three terminated packages, it had been split into 09 contract packages and re-bided by the Program in the year 2021. Out of those, only 07 contract packages had been awarded to the selected contractors as at 31 December 2022. The value of the re-awarded contracts had been increased by Rs.1,040.64 million when compared with the original contract prices of the terminated packages and the value of work done up to termination. | Contract prices were obviously high compared to the terminated contracts.

Although values of re-awarded contracts had been increased by Rs.1,040 Mn, this cost would be reduced on | Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost. |

- Further, it was observed that the cost could be increased further when awarding the remaining two packages in the future. employer's claim and encashment of performance bonds.
- (d) Although the engineer had recommended to terminating the BA-06 contract on 10 December 2020 due to the slow progress of the road construction, the Program released the second part of the mobilization advance amounting to Rs. 90.47 million on 05 January 2021. Subsequently, action had not been taken to recover the advance payment guarantee until 28 February 2021. It could not be deny or withheld while the termination recommendations are processed. Action should be taken to avoid the overpayments to the contractors.
- (e) Even though the lending agency had instructed to recover mobilization advance and refund to the lending agency related to the terminated contracts, the Program couldn't be able to recover a sum of Rs.560.14 million more than a period of one year because a court case had been filed by the contractors against encashment of the Mobilization Advance Bonds. The case has been filed against us in Commercial High Court on the prevention of encashment of guarantees. Action should be taken to encash the securities immediately after the termination of the contact.
- (iii) Although the engineer estimates, bid documents and bill of quantities should be properly evaluate by the Procurement Committee and Technical Evaluation Committee as per Sub Clause 2.4 and 2.6 of the Government Procurement Guideline, the loss of Rs.48.2 million had been incurred by the program as at 31 December 2022 in respect to BA 4 and BA 5 contract packages due to rate discrepancies and wrong interpretation of items in engineer estimates, bid documents and bill of quantities. In future contracts, action will be taken not to utilize such items in the BOQs after awarding the contracts. Also, request will be made to ADB to change their bid evaluation guidelines. Action should be taken promptly to recover the loss.
- (iv) Although all laboratory, furniture and survey equipment will be reverted to the contractor at the end of the Program as per Sub clauses 108.4 and 120.7 of the Conditions of the Contracts, a sum of Rs. 518.99 million and Rs. 14.13 million had been paid as a lump sum for laboratory, furniture and survey equipment respectively as at 31 December 2022. Thus it may indicate that favorable contract conditions may lead to undue benefits to the contractors. The PMU drafted these conditions, because the RDA has sufficient stock of similar equipment. Instruction should be given to follow the conditions of contracts.

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| (v) | The Program had failed to encash the performance guarantees with the value of Rs.690.74 million relevant to 03 terminated contract packages even by the end of the year under review due to delay in the actions taken on encashment by the Program. | The contractors have taken court orders to prevent encash the Performance Guarantees and litigation is in progress. | Action should be taken to encash the securities immediately after the termination of the contract. |
| (vi) | The accumulated unrecovered mobilization advances as at 31 December 2022 was Rs.9,984.24 million and the recoverability could be uncertain due to the delay in payments to the contractors until releasing the balance tranches of the loan. | Soon after commencing the payments to IPCs, Mobilization Advances can be recovered. | Immediate action should be taken to recover the mobilization advances. |
| (vii) | The delay in the re-bidding process of the terminated contracts in Uva Province had directly affected to the smooth functioning of road rehabilitation works. Although there is a pay item under the Particular Condition 103.2 (2) of the road rehabilitation work contracts to routine maintenance of existing roads, 04 additional contracts had been awarded at a value of Rs. 66.26 million to cover the emergency maintenance works until the rebidding contracts were awarded. It was directly affected to overrun the cost of the Program. | Incurring this cost to cover the emergency maintenance works until the rebidding contracts were awarded is unavoidable. | Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost. |
| (viii) | According to Section 8.9.3 of the Procurement Guideline 2006, the contract agreement should be signed by the Secretary to the Line Ministry in case of a contract value over Rs. 500 million. However 66 civil work contracts and 4 consultancy contracts over that limit of the Program had been signed by the Chairman of the Road Development Authority. | In pursuance of the Road Development Authority Act No. 73 of 1981, the Chairman of the RDA has been authorized to sign all the contracts entered with RDA. | Adhere to the Procurement Guidelines. |

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3.3 Advisory Services

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(i)	Although RMTF had been planned to be reorganized and expanded to cover local road maintenance, the policy options in the report furnished by the specialist had not been revealed as at the end of the year under review.	Some of the principle level decisions are still pending. Therefore, RMTF reorganizing has not become success.	Action should be taken to evaluate the consultant's work within the contract period.

3.4 Road Rehabilitation Procurements

No	Audit Issues	Responses of the Management	Auditor's Recommendations
	<p>The Program implemented the rehabilitation of 54.52 km of 06 national roads in the Western province. According to the procurement Plan, the procurement process had been planned to be completed as at 15 September 2021. The estimated cost of the above 06 packages was Rs.7,810 million. The following observations are made.</p>		
(i)	<p>Although the Technical Evaluation Committee had recommended negotiating the bided price submitted by the contractor for package -2 at its meeting held on 19 November 2021, the Ministry Procurement Committee had decided to award the contract to the particular contractor without any price negotiation. Further it was observed that undue benefits given by the Ministry Procurement Committee to contractors without adhering to the Technical Evaluation Committee recommendations may directly affect to overrun the project cost uneconomically.</p>	<p>The MPC is in the opinion that construction activities are complicated in this section of road due to high traffic volume.</p>	<p>The procurement committee should follow the recommendations made by the TEC.</p>
(ii)	<p>According to Section 7.9.2 of the Procurement manual, if the lowest evaluated responsive bid exceeds the engineer's estimates by a substantial margin, the Procurement Entity should request new bids or negotiate with the bidder to obtain a satisfactory contract price. The following observations are made.</p>		
(a)	<p>Three national road contracts in the western Province had been awarded to the contractors even though the negotiated bid prices are significantly higher than the Engineer's Estimate and it varied between 21 per cent to 28 per cent.</p>	<p>Agreed.</p>	<p>Action should be taken to follow the conditions of the Procurement Guideline.</p>
(b)	<p>Four rural road contract packages in Vaunia District (VA-01 to 04) had been awarded with significant variations ranging from 33 per cent to 39 per cent even after the negotiations.</p>	<p>The TEC was in the opinion that the quoted prices are reasonable and award the contract.</p>	<p>The conditions of the Procurement Guideline should be strictly followed.</p>

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| (iii) | The Program had included a special clause under 1.6 in Section 3 of the bidding documents to enable the lowest evaluated substantially responsive bidder to allow more than one contract contrary to the Standard Bidding Documents of the Government Procurement Guideline. Therefore the lowest evaluated substantially responsive bidder couldn't be able to bid more than one contract package. Out of the five packages which had already been awarded under this method and the cost overrun was Rs. 695.45 million as at 31 December 2022. | Agreed.
This criterion was introduced to avoid failure in the implementation stage when a contractor was awarded several contracts. | The conditions of the Procurement Guideline should be strictly followed. |
| (iv) | Although all packages had been planned to award before 21 September 2021 as per the Procurement Plan, two packages valued at Rs. 4,320.25 million and named NR/1 and NR/3 had not been awarded to the contractors even as at 31 December 2022. It was observed that a delay over 15 months as at 31 December 2022 and the validity of the bids of those two packages in the future were doubtful in the audit. | Agreed.
Awarding decision is withheld due to the non-availability of funds under the program. | Action should be taken to expedite the procurement process. |
| (v) | Although 21 procurements with an estimated cost of Rs.7,163 million had been planned to be completed as at 31 December 2022 as per the Procurement Plan of the Program, it was observed that those procurement had not been completed due to the delay in signing of tranche 4 of the loan agreement. | Agreed.
Procurement activities delayed due to funding issues. | Action should be taken to expedite the procurement process. |

3.5 Observations made on site visits

No	Audit Issues	Responses of the Management	Auditor's Recommendations
	The following observations were made during the field inspection conducted in Vaunia District road constructions.		
(a)	The rehabilitation works on 13 roads of those contract periods are already extended ranging from 72 days to 359 days comprising 19.66 km in VA 01 and VA 04 contract packages had not been even commenced as at 31 December 2022.	National Budget circular regarding controlling of Public expenditure were influenced to stop the construction works.	Maximum effort should be taken to achieve intended targets of the program within the time frame to avoid additional cost.
(b)	Although the contractors shall take necessary measures for the safety of traffic and third parties by providing erecting and maintaining all signs, lamps, barriers, traffic control signals, road marking etc. and barriers shall be strong red lanterns or warning	Having noted shortcomings at the site, the Contractor was advised repeatedly to comply with the	Employer and consultant should review the safety measures effectively.

lights shall be mounted on the barriers at night as per Sub Clause 103 of the Technical Specifications, the contractors of the VA 03 and VA 04 packages failed to comply with those requirements. Further, it was observed that a total sum of Rs.18.05 million had been paid to those contractors.

requirements and letters issued.

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| (c) | Although the construction of built-up access to premises shall be done within the least possible time without much inconvenience to the owners of the premises on either side of the road and the road users as per sub clause 701 of the specifications, the access roads for houses had not been prepared in road ID NAV 026, NAV 066 and NAV 046 in VA 03, VA 02 and VA 04 packages respectively. | The Contractor has provided access on a temporary basis within the least possible time without causing much inconvenience to the owners of the premises and the road users. | Road access should be given within the least possible time. |
| (d) | Although it had been informed that the laying of asphalt of NVA 026 and NVA 062 roads to be completed on 21 December 2021 and 28 September 2021 respectively, instances were observed where the incomplete road shoulders, structures, road markings and signing boards etc. and further observed that delay in the completion of shoulders may cause to erode the edges of the asphalt layer and deteriorate the quality and durability of the roads. | The completion of identified outstanding works was affected significantly due to the shortage of construction materials in the local market and poor cash flow situation. | Instruction should be given to follow the specifications. |

3.6 Extraneous Payments

Audit Issue	Response of the Management	Auditor's Recommendations
Accumulated Commitment charges amounting to US \$ 0.46 million equaling Rs.90.50 million had been paid by the Program uneconomically to the Lending Agency on un-disbursed proceeds of the loan as at 31 December 2022.	It is expected to minimize Commitment Fee by utilizing the tranches within the planned period.	Action should be taken to utilize loan funds efficiently.

3.7 Issues Related to Human Resources Management

Cadre Position	No of Posts			Response of the Management	Auditor's Recommendations
	Approved	Actual as at 31 December 2022	No. of vacancies		
Senior Engineer Coordinating	6	2	4	Appointing authority had given approval to recruit only the essential staff as per the service requirement.	Optimum cadre should be recruited by the program to maximize the performance.
Engineer	14	3	11		
Project Engineer	28	17	11		

3.8 Issues Relating to the Project Monitoring Unit

Key Cadre Position	Period of the service in the PMU	Whether employed in other entities	Employed on contract basis/acting basis	Responses of the Management	Auditor's Recommendations
Project Director (Uva)	25 month	Yes (Road Development Authority)	Acting basis	Although applications have been invited several times to recruit for the post, no other applicants who have met the basic qualifications.	The Project Director should always be recruited on full time basis as per circular instructions.

3.9 System and Controls

Audit Issue	Response of the Management	Auditor's Recommendation
According to the Facility Administration Manual of the Program and Section 9 of the Management Services Circular No.01/2019 dated 05 March 2019, the Project Steering Committee should be conducted at least quarterly to oversee, monitor and coordinate project implementation. However, it was observed that meetings had not been conducted in the 2nd and 4th quarters of the year under review.	Two Project Steering Committee meetings have been held during the year 2022.	Steering Committees should be implemented as per stipulated manner.