

Inclusive Connectivity and Development Project - 2023

The audit of financial statements of the Inclusive Connectivity and Development Project for the year ended 31 December 2023 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 55 of the Project Appraisal Document dated 08 September 2021, entered into between the Democratic Socialist Republic of Sri Lanka and the International Bank for Reconstruction and Development. 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 Agreements, then Ministry of Highways, presently the Ministry of Transport 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 provide safe, efficient and climate resilient connectivity and strengthen agricultural supply chains to empower Project communities in selected Districts of Sri Lanka. As per the Loan Agreements, the estimated total cost of the Project was to US\$ 500 million equivalent to Rs. 101,499.6 million was agreed to be financed by International Bank for Reconstruction and Development. As per the Restructuring Paper No: RES51645 dated 19 April 2023, the loan amount reduced to US\$ 150 million equivalent Rs. 54,000 million due to reallocation US\$ 325 million for the Contingent Emergency Response Component (CERC). The amount of US\$ 0.83 million equivalent to Rs.300 million is expected to be financed by the Government of Sri Lanka. The Project had commenced its activities on 03 November 2021 and scheduled to be completed by 31 October 2026.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Basic 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 2023 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 the Management and those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, 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 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 Accounting Deficiencies

	Accounting Deficiencies	Amount Rs. (million)	Response of the Management	Auditor's Recommendation
(a)	According to the Section 2.03 the Loan agreement, the commitment charges and interest had not been accounted in the financial statements as at 31 December 2023.	6,392	Commitment charges and interest associated with the loan has not been incurred as a component of the loan agreement.	Commitment and interest charges should be accounted.
(b)	The mobilization advance included in the outstanding interim payment certificates as at the end of the year under review had not been accounted in the financial statements.	33.43	The outstanding Interim Payment Certificates for four contract packages have been accounted without considering the mobilization advance recovery amount.	Outstanding mobilization advances should be accounted accordingly.
(c)	Although the retention deducted from outstanding interim payment certificates during the year under review should be identified separately in the financial statement, the retention value relating to Lot No. 2 of package 251198 and Lot No. 3 of package 251205 in Matale and Monaragala Districts respectively had not been included as retention payable in the financial statement in the year under review.	4.3	It will be corrected in the future when making provisions for Interim Payment Certificate.	The retention amount should be shown accordingly in the financial statements.
(d)	As per the Clause 14.3 (iii) of the condition of the contract, the retention could be held 10 per cent of work done up to the limit of 5 per cent of the contract sum. It was observed that retention amount had been over recovered from the contractor as at end of the year under review.	4	The retention of the particular contract package has been deducted erroneously by exceeding the maximum limit of 5 per cent of the contract sum. However, this over deducted retention amount has been adjusted from the next Interim Payment Certificate.	The contract management process should comply with the conditions of the contract and action should be taken to protect the rights of both parties.

2.2 Non-compliance with Rules and Regulations

No	Reference to the Laws, Rules and Regulations	Non-compliances	Responses of the Management	Auditor's Recommendations
(a)	Section 8.4 and 8.7 of the General Conditions of the Contract	The contractor would be entitled to an extension of time (EOT) to complete the works owing to the acceptable reasons stated in the General Conditions of the contract. However, 07 contracts had been continued as at 31 December 2023 without an approved EOT and action had not been taken to grant an EOT before expiry of the approved time period of the contract or charge the liquidated damages for the delay period contrary to the General Conditions of the Contract.	The country's economic crisis had a profound impact on Contracts in Ratnapura, Matale and Anuradhapura Districts & characterized by fuel shortages, a scarcity of construction materials, and a shortage of labourers due to transportation issues. In response to these challenges, contractors periodically requested Extensions of Time (EOT) in accordance with the procedures outlined in the Conditions of Contracts.	The contract management process should comply with the conditions of the contract.
(b)	Schedule 2 Section I.B 2 of the Loan Agreement	Although a Project Operations Manual (POM) should be prepared not later than three months after the effective date of the loan agreement, the evidences were not revealed to audit regarding such manual use by the Project for operational activities as at end the year under review. Further, this matter was also pointed out in our audit reports in the previous year, and the audit in the view that this situation may directly affect the achievement of the intended targets during the project period.	Project Operations Manual (POM) prepared for the project has to be revised with the restructuring of the loan. Hence, as per the comments given by the World Bank during the last mission in October 2023, adjustments were made to the POM.	Adhere to the conditions of the loan agreement.
(c)	Paragraph 9.3 of the Management Services Circular No. 01/2019 dated 05 March 2019	Although the Steering Committee meetings of the Project should be conducted at least once in two months, it was observed that only 04 meetings had been conducted during the year under review.	Project Steering Committee meeting is conducted considering the priority of matters and its exigencies. Basically, Project was in its implementation stage and functioning of project activities smoothly in the year under review.	All Steering Committees should be implemented as per stipulated manner.

- (d) Procedure CA 38 of Guide to Project Management and Contract Management for Infrastructure Development Project (Works) dated February 2012
- The progress meetings should be conducted monthly with the participation of the Engineers, Project Director, Contractor’s representatives and Engineer’s senior staff. However, it was observed that the intended number of meetings had not been conducted in several Districts.
- As the PMU staff have to be attended for road identification activities, procurement related activities related to other proposed Districts parallelly, it was unable to conduct progress review meetings monthly for some Districts.
- Adhere to the particular guidelines

3. Physical Performance

3.1 Physical Progress of the Activities of the Program

- (a) Road rehabilitation

Component	Activity	As at 31 December 2023		Delay/Audit Issue	Reasons for delays
		Expected physical performance	Performance achieved		
		Km	Km		
Enhancing Safe and Climate Resilient Transport Connectivity	Rehabilitation, improvement and maintenance of rural road	1,096.8	251.18	The overall physical progress of the civil works represented only 27.04 per cent as at 31 December 2023 even 02 years after the Project was initiated.	Poor performance of the contractors.

Response of the Management

Civil work progress reflects the progress of all the construction activities of awarded contracts. This is not limited to the fraction of asphalted road length out of total length.

Auditor’s Recommendations

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

(b) Road rehabilitation contract awarding

Component	Activity	As at 31 December 2023		Delay/Audit Issue	Reasons for delays
		Expected physical performance	Performance achieved		
		Lots	Lots		
Enhancing Safe and Resilient Transport Connectivity	Contract awarding of rehabilitation, improvement and maintenance of rural roads	27	24	It was observed that rehabilitation works had been completed only in 02 lots as at 31 December 2023 and the physical progress of the remaining 22 lots had remained at 15.45 percent to 99.3 percent. Further, it was observed that the initial contract period of incomplete 08 lots in Rathnapura, Mathale and Anuradhapura Districts had ended as at 31 December 2023.	Poor performance of the contractors and poor contract administration

Response of the Management

At the end of December 2023, a total of 24 contracts have been awarded in 7 districts. As civil work contracts are awarded in different time slots, the progress of each contract depends on the program of the relevant contract. The progress of one contract cannot be compared with the progress of other contracts. However, two contracts completed on time even with the prevailed economic crisis.

Auditor's Recommendations

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

3.2 Contract Administration

Selection of Contractors in Rathnapura District in Sabaragamuwa Province

The selection of the contractors for rehabilitation/improvement and maintenance of 76.62 km of rural roads in Rathnapura District had been procured under four lots and following observations are made.

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Although it was recommended to re-tender Lot 3 & 4 by the recommendation of the Technical Evaluation Committee, the Procurement Committee had decided to award the contract by revising the	Following the World Bank's recommendations, the decision to retender was rescinded. Subsequently, the Engineering Estimates were revisited in line	Adhere to the procurement guidelines and an investigation should be conducted

Engineering Estimates at a cost of Rs.1,150 million and Rs.824 million respectively and further, the recommendations of the TEC had not been obtained for revised Engineering Estimates and award the contracts. with their guidance. Concurrently revised estimates together with Bid Evaluation Report (BER) forward to the Ministry Procurement Committee. regarding the discrepancies.

- (b) The accepted lowest evaluated bid prices of Lot 03 and Lot 04 were higher than 23.65 percent and 26.31 percent respectively even after revising the engineering estimates contrary to Paragraph 7.9.2 (n) of the Procurement Manual. The procurement process was conducted through national competitive bidding, with the tender published nationally. The Technical Evaluation Committee (TEC) recommended and initially, the Ministry Procurement Committee (MPC) decided to retender Lot-3 & Lot-4 due to the deviation from the original engineer's estimates. Adhere to the procurement guidelines and an investigation should be conducted regarding the discrepancies.
- (c) Although the variations in the lowest evaluated bid prices even after revised Engineering Estimates indicated an over 23 percent increase, the Ministry procurement committee had decided to award the contract without negotiation with the relevant contractors or rebidding contrary to Section 5.58 (c) of the World Bank Regulations for IPF Borrowers. The World Bank Regulation for IPF borrowers serves as a guideline for the procurement procedure, rather than for bid evaluation and the bidding document. Adhere to the procurement guidelines and an investigation should be conducted regarding the discrepancies.

3.3 Underutilized Resources

No	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	As per the activation of the Contingent Emergency Response Component (CERC) of the project and allocation of funds in response to the recent economic crisis, debt crisis and liquidity shortages in the foreign exchange market the initial loan amount of US \$ 500 million had been reduced up to US \$ 175 million after allocated of US \$ 325 million to CERC. It was observed that the Project had utilized only Rs.13,951.87 million as at 31 December 2023 out of the total allocation of US\$ 175 million equivalent to Rs.59,062.51 million of the Projects. The slow progresses of the ongoing contracts and delay in the commencement of Component 2 of the project are mainly affected to that poor utilization of loan funds.	It was unable to achieve the target due to adverse behavior of economic factors prevailed in the country and the economic downturn.	Loan funds should be utilized effectively.

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| <p>(b) The Project had utilized only Rs.9,045.64 million out of loan funds allocation of Rs.11,674.16 million and it was represented 77.48 per cent of the allocation made during the year under review.</p> | <p>This was mainly due to delay in project performance with adverse behavior of economic factors prevailed in the country and the economic downturn, adverse weather condition & delay in process of awarding some contracts during the year 2023.</p> | <p>Action should be taken to utilize loan funds effectively.</p> |
| <p>(c) As per the Special Dollar Account No. 73633 (SL-2019) of the project, the project had disbursed a sum of US \$ 26.5 million equivalent to Rs.8,638.70 million as advances during the year under review and a sum of US \$ 6.72 million equivalent Rs.2,174.55 million had remained without being used at the end of the year. The audit in the view that the advances should be requested after proper evaluation to curtail the commitment charges that have to be paid uneconomically to the lending agency.</p> | <p>Expected project targets were unable to achieve due to delay in project performance with adverse behavior of economic factors prevailed in the country and the economic downturn, adverse weather condition & unavoidable delay in procurement process of awarding some contracts during the year 2023.</p> | <p>Action should be taken to utilize loan funds effectively.</p> |

3.4 Delays in implementation of activities of the Project

Audit Issue

Response of the Management

Auditor's Recommendations

(a) Improving Institutional and Policy Framework of the Road Sector - (Sub-Component 1.2)

As per the Project Appraisal Document, a sum of US\$ 5 million had been allocated to the improving institutional and policy framework of the road sector under Sub-Component 1.2. This Sub-Component aims to improve the overall management of the road sector to sustain and increase efficiencies and improve its ability to respond to evolving connectivity needs and challenges. However the intended functions such as developing a rationalized road improvement program targeting the provincial and rural road network, reviewing the institutional set up to identify opportunities for streamlining the structure and mandates of public institutions responsible for managing the road sector and exploring different mechanisms to improve financing

Due to limited number of Project Engineers in PMU office of ICDP and activities proposed under aforementioned Component are not limited to ICDP, PMU seek the support of relevant divisions of RDA in order to streamline the activities to improve the overall management of the road sector.

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

of resilient road constructions and maintenance of rural roads within the governing framework had not been implemented even after laps of 02 years from the date of commencement of the activities of the Project.

(b) Road Sector and Community Capacity Enhancement - Sub-Component 1.3

According to Section 24 of the Project Appraisal Document and Project Restructuring paper No.RES 51645 dated 09 May 2023, a sum of US \$ 7.25 million out of US\$ 8.75 million had been allocated for this Sub-component. However, only a sum of Rs.1.14 million had been incurred as at 31 December 2023 for the intended functions under this component such as capacity building for public sector institutions, climate resilient road network planning, design, maintenance and knowledge development, capacity building for service providers in the local construction industry and capacity building and training for local community groups. Therefore, the achievement of targets of each sub-component during the project period is doubtful in the audit.

PMU already had taken the initiatives to implement activities under Component 1.3. Further, PMU will take every measure to implement activities under aforesaid Component promptly.

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

(c) Implementation of Component - 2 : Enhancing Supply Chain and Access to Services for Farmers

As per the Cabinet Approval and Cabinet Memorandum, it was recommended to prepare and establish a joint implementation mechanism along with the Ministry of Agriculture to implement the Project. Initially, a sum of US\$ 50 million had been allocated to this Component and it was reduced to US\$ 15 million from the restructuring paper on 09 May 2023. However, this component had not been commenced even as at end of the year under review contrary to the recommendations of the above Cabinet Paper.

As per the Loan Agreement of the Project, activities related to Component 2 are under Ministry of Agriculture (MOA) and delay in finalizing the proposal. Therefore, once the PMU receive the approved proposal, action will be taken to implement the Component 2.

Maximum effort should be taken to achieve intended targets of the Project within the time frame.

3.5 Matters in Contentious Nature
Audit Issue

Response of the Management

Auditor's Recommendations

Activation of the Contingent Emergency Response Component (CERC) under the Project

According to the letter dated 09 May 2022 of the Secretary to the Treasury and the subsequent letter sent by the Country Director of the World Bank dated 18 August 2022, an amount of US \$ 325 million had been allocated for the Contingent Emergency Response Component of the Project. The CERC funds had been allocated to minimize the impact of the economic crisis and restore social stability by providing immediate needs and essential items and social protection .Following observations are made in this regard.

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| (a) | Approval of the Cabinet of Ministers had not been obtained for the changes of the initially approved scope of the Project. | Separate restructuring paper has been circulated. | Approval should be taken to deviate the initial objectives. |
| (b) | After limitation of the Scope of the Project, the Project Development Objectives, Project Results Framework, Implementation Arrangements, Disbursement Targets and Conditions, Environment and Social Framework should be change accordingly. However, the Project Appraisal Document had not been revised accordingly as at 31 December 2023. It may be badly affect to the proper progress in future. | Revision of project appraisal document to be carried out with the collaboration of funding agency. Letter send by Country Director to Secretary to Treasury on 6 April 2023 with all amendments were highlighted related to Loan Agreements as well as Project Appraisal Document. | Action should be taken to revise Project Appraisal Document as per the revision. |
| (c) | After approving of the restructuring paper on 09 May 2023, the total cost of the project was reduced due to reallocated a sum of US\$ 325 million for the emergency crisis response package through the activation of the Contingent Emergency Response Component (CERC). However, the salaries of the staff of the Project Monitoring Unit had been paid by considering the limits entitled before restructuring the project, contrary to Paragraph 3.2 of Management Services Circular No. 01/2019 dated 05 March 2019. | After approved the restructuring paper, renewal of PMU staff contracts was adjusted to reflect the revised salaries accordingly. | Adhere to the Circular instructions. |