

Second Integrated Road Investment Program (iRoad II) - 2023

The audit of financial statements of the Second Integrated Road Investment Program 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 4.03 Article IV of the Loan Agreements No. 3579 SRI and No. 3580 SRI (COL) dated 22 November 2017, Loan Agreement No. 3851 SRI dated 13 November 2019, No. 4067 SRI dated 28 May 2021 and No. 4384 SRI dated 28 November 2023 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 Project

According to the Loan Agreement, the Ministry of Higher Education & Highways, presently the Ministry of Transport and Highways is the Executing Agency and 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 Agreement, 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 Rs.28,115 million is expected to be financed by the Government of Sri Lanka. 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 Basis for Qualified Opinion section of my report, the accompanying financial statements give a true and fair view of the financial position of the Program 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 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	Amount Rs.million	Response of the Management	Auditor's Recommendation
(a)	Contrary to the Sri Lanka Public Sector Accounting Standards No.08, provision had not been made for doubtful recoveries on mobilization advances of 07 terminated contracts which	1,453.96	Subsequent to termination of Contracts, the Employer took action for recovery of the Advance payment as per the condition of the Contract. The validity of the Advance payment Guarantees of six Contractors have been	Mobilization advance bonds should be submitted to encashment before due date and should be recorded as receivables.

had been terminated during the year under review.

extended. Since the recovery was not doubtful from the perspective of the Employer as per the condition of Contract.

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| (b) | The provisions for Dispute Arbitration Board claims amounting to Rs.907 million and payments for laboratory, furniture and survey equipment and details of terminated contracts couldn't be verified as at 31 December 2023 as the details were not furnished to the audit. | 907 | The requested information could not be submitted to the Audit in time due to delay in collecting details with the limited staff available. | Separate files and registers should be maintained for each arbitration matter and all contract administration documents should be kept until settle the arbitrations. |
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2.2 Non Compliance with Laws, Rules and Regulations

No	Reference to the Laws Rules and Regulations	Non Compliance	Response of the Management	Auditor's Recommendation
(a)	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, 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 2023.	This item was paid as per the BOQ item and conditions of contract. However, these items was removed in consequent packages.	Adhere to the condition of contract.
(b)	Sub Clause 2.4 and 2.6 of the Procurement Guideline	Although the engineer estimates, bid documents and bill of quantities should be properly evaluate by the Procurement Committee and Technical Evaluation Committee, the loss of Rs.48.2 million had been incurred by the program as at 31 December 2023 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. The evidences were not revealed to the audit regarding the actions taken in respect of the responsible parties.	Procurement was carried out on a competitive basis. There is no provision in ADB guideline to go for negotiation for high rate item when the overall bid price is reasonable.	Action should be taken promptly to recover the losses.

- (c) Sub clauses 108.4 and 120.7 of the Special Conditions of the Contracts
- Although all laboratory, furniture and survey equipment will be reverted to the contractor at the end of the Program, 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 up to 2022 and the payments made during the year couldn't be verified due to evidences were not being furnished to audit. Thus it may indicate that favorable contract conditions may lead to undue benefits to the contractors.
- The contractor has quoted these rates only for using the equipment during the construction period. Therefore, this condition will not give any undue benefit to the contractor. Further, the PMU drafted these conditions, because the RDA has sufficient stock of similar equipment.
- The special conditions of the contract should be carefully reviewed before enforcement. Special attention should be drawn by TEC and PC when reviewing the bidding documents to secure the employer rights, keep value for money and avoid undue benefits to contractors.
- (d) Section 9.3 of the Management Service Circular No. 01/2019 dated 05 March 2019
- Although the Steering Committee of the Project should be conducted at least once in two months, only one meeting had been held during the year under review.
- Meetings were not called on regular basis as the works had been suspended during this period.
- Adhere to the Circular instructions.

3. Physical Performance

3.1 Physical progress of the activities of the Project

The program intends to improve rural roads and national roads to improve connectivity between rural communities and socioeconomic centers to increase transport efficiency on selected roads in the Eastern, Northern, Uva and Western provinces. The following observations are made.

(a)

Component	Activity	As at 31 December 2023		Audit Issue	Reasons for delays
		Expected physical performance	Performance achieved		
		km	km		
Completion of rehabilitation works of National and Rural roads.	Rural roads	3,654.95 km	2,115 km	According to the Updated Facility Administration Manual – November 2023, 53 packages had been designed under 04 Provinces to improve 3,654.95km of rural roads. However, 2,115 km (57.87 %) only had been completed at the end of the year under review.	Limitation of the government borrowings and delay in completion of the contracts

Response of the Management However, due to limitation in government borrowing, completion of full scope is not being possible. With the activation of Tranche 4 loan and measures have been taken to complete the critical works.

Auditor’s Recommendation Maximum effort should be taken to achieve intended targets of the Program within the time frame.

(b) Component	Activity	As at 31 December 2023		Audit Issue	Reasons for delays
		Expected physical performance km	Performance achieved km		
Completion of rehabilitation works of National and Rural roads.	National roads	06 roads with a length of 54.45 km	05 roads progress below 01 per cent and 01 road achieve 38 per cent progress.	Although, an actual length of 54.45 km of 06 national roads had been planned to rehabilitate under Western Province, it was observed that the physical progress of 5 national roads was below 01 per cent as compared with those intended targets ranging between 01 to 80 per cent and only one package (NR 07) could be able to achieve 38 per cent physical progress as at 31 December 2023 out of it intended target of 100 per cent at the end of the year under review.	Limitation of the government borrowings and delay in completion of the contracts.

Response of the Management Due to funding issues, 5 Contracts of National roads in western province were terminated by the Employer for convenience. However, one contract (NR/7) is in progress.

Auditor’s Recommendation Maximum effort should be taken to achieve intended targets of the Program within the time frame.

(c)

Component	Activity	As at 31 December 2023		Audit Issue	Reasons for delays
		Expected physical performance	Performance achieved		
		Lots	Lots		
Completion of rehabilitation works of National and Rural roads.	Acquisition of donated lands	4,075	2,752	Although 4,075 land lots were donated by the respective land owners to the project during the road rehabilitation works, it was observed that the related consent letters and other documents of 1,323 land lots had not been handed over to respective Local Authorities at the end of the year under review.	Delay in completion of the rehabilitation works of respective roads.

Response of the Management 1323 land lots will be handed over to the respective authorities once the rehabilitation works of the roads are completed.

Auditor's Recommendation Criteria should be introduced for handing over the documents to respective authorities.

3.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Although the employer shall pay the amount certified in each IPC within 56 days as per Sub Clause 14.7 of the General Conditions of the contract, it was observed that payables to contractors for civil works was Rs.5,558.94 million as at 31 December 2023. Out of that, Rs.1,188.03 million was certified IPC values of year 2022 which had not been paid even end of the year under review. Furthermore, the provision of Rs.2,074.11 million for delay interest had been made as at 31 December 2023 as per the Sub Clause 14.8 of the General Condition of the contract. Therefore, the delays in payments to the contractors will make additional cost and burden to the government.	The works have been suspended in early 2023 and several IPC payments have been withheld due to insufficient funds. However, after receiving tranche 4 loan of the Program, considerable amount of IPCs were paid. But, interest payments for delayed payments have to be paid from GOSL Funds as per the conditions of contract.	Measures should be taken to minimize delay interest and should be certified the accuracy of the claims.

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| (b) | The recoverability of mobilization advances of Rs.8,197.88 million as at 31 December 2023 could be uncertain due to the delay in payments to the contractors and descoping the balance work of road rehabilitations. | Most of the on-going contracts are descoped due to funding limitations. Therefore, the advances cannot be recovered as planned. However, actions are being taken to recover the balance amount of mobilization advances. | Policymakers should introduce measures to recover the advances when descoping the balance works of rehabilitation. |
| (c) | It was observed that 10 contract packages in Uva, Nothern and Western provinces had been terminated by employer and the contractors as at 31 December 2023 and mobilization advances amounting to Rs.2,014.10 million couldn't be recovered from those contractors as at 31 December 2023. | Steps are being taken to recover the advances as per the conditions of contract. | Immediate actions should be taken to recover by encashment of the advance bonds or losses should be recovered from responsible officers and disciplinary actions should be taken. |
| (d) | The recoverable amounting to Rs.690.74 million from 03 terminated contracts was remained as unrecovered for more than 02 years due to delay in the actions taken on encashment of the performance bonds by the Program. As a result of those delays may take by the contractors as an opportunity to take legal actions against encashment of the performance guarantees. | Encashment withheld due to injunction orders. | Investigation should be conducted to identify the responsible officers and losses should be recovered. |

3.3 Advisory Services

The Program had entered an agreement with a Public Administration Specialist on 03 January 2022 at a value of Rs.8.2 million to obtain consultation on expanding the Road Maintenance Trust Fund (RMTF) to cover local road maintenance, expanding the RDA's responsibility to local road maintenance, assisting the improvement of the accounting capacity of RDA and develop a comprehensive accounting and financial manual for the Program. The following observations are made in this regard.

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Although the Public Administration Specialist had been appointed to reorganizing and expanding Road Maintenance Trust Fund, it was observed that, the RMTF had not been implemented even at the end of the year under review as per the budget proposals in 2023.	Payments were made only for work done, which was not covered in the scope of this item.	Ensure the return for the cost incurred.
(b)	The evidences were not revealed to the audit regarding the usage of the content of the Manual for accounting practices of the Program and the Road Development Authority.	The Secretary to the Ministry of Transport & Highways has appointed a committee to evaluate the Accounting & Financial Management Manual submitted by Consultant. Subsequently the Committee report has been received to the PMU to implement its recommendations. Steps are being taken to implement the above recommendations.	Ensure the return for the cost incurred.
(c)	A sum of Rs.5.17 million had been paid to the Public Administration Specialist as at 31 December 2023 and it was representing 63 per cent from the contract value. The completion and effectiveness of this contract is doubtful in audit due to abnormal delay in completion of the targets.	As per the Term of Reference (TOR) of Public Administration Specialist, the following reports were submitted. <ul style="list-style-type: none"> • Inception report on 28.02.2022 • Assessment of Rural Road Maintenance on 30.05.2022 • Accounting & Financial Management Manual on 30.07.2022. • Financial Plan for Rural Road Maintenance on 02.12.2022. 	Ensure the return for the cost incurred.

3.4 Underutilized Resources

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Generally, the entire loan amount of US \$ 900 million is released by the donor in several tranches from time to time under multi-finance facility. The donor had released USD 500 million under three tranches according to their regular disbursement method before 31 December 2023. However, the processing was withheld	The program is a Multi tranche Financial Facility (MFF) with 10 year implementation period. A sum of USD 560 million was received in 4 tranche and the balance amount of USD 340 million is uncertain due to limitation of Government borrowing resulted in economic	A proper Action Plan should be prepared and approved base on activities identify for descope allocation.

as a result of the macroeconomic crisis. Later, it was decided to provide further USD 60 million under tranche 4 of the Program to carry out the critical works of the already commenced and incomplete road section, maintenance of not commenced roads and payment of previous work done relating to both iRoad and Second iRoad programs. A sum of USD 508.52 million equivalent to Rs.109,316 million had been utilized as at 31 December 2023 from agreed loan amount of USD 900 million equivalent to Rs.137,070 million and it represented 56.50 per cent from the total allocation as per the loan agreement. Out of that a sum of Rs.1,376.64 million had been spent for civil works of iRoad Program as at 31 December 2023.

(b) As per the loan agreement signed on 28 November 2023 for the tranche 4 under Second Integrated Road Investment Program, it had been provided a sum of USD 60 million for both iRoad and iRoad II programs in order to attend the critical works of the already commenced and incomplete road section and payment of previous work done. Out of that, only USD 8.98 million equivalents to Rs.2,935.33 had been disbursed as at 31 December 2023.

(c) Although initially it was decided to allocate a sum of Rs.23,699.50 million during the year under review, an amount of Rs.3,600 million had been provided under supplementary allocation through domestic funds as retroactive finance. A sum of Rs.3,992.85 million or 14.63 per cent had been utilized out of the total allocation during the year under review.

crisis.

Recently approved iRoad2 tranche 4 has the provision for the expenditure of iRoad1 & iRoad 11 Programs. Accordingly, payments have been made.

Tranche 4 loan was effective from 3 December 2023 and planned to be disbursed over the period of loan closure which will be in 31 March 2027.

Major portion of the tranche 4 will be utilized in 2024 and 2025 once the planned critical works are completed.

Even though budget estimate was made for 2023, contractors were instructed for temporary suspension of works until next tranche loan is received. iRoad II tranche 4 loan was effective from 03 December 2023. Therefore, actual expenditure was much less than anticipated.

A proper Action Plan should be prepared and action should be taken to approve the amended FAM

Action should be taken to revise the allocations and effective measures should be taken to achieve the outcome without delay.

3.5 Matters in Contentious Nature

Audit Issue	Response of the Management	Auditor's Recommendation
<p>According to the report of Public Expenditure Review Committee (PERC) for Ministry of Transport and Highways issued on 13 July 2023, although the committee was recommended to complete the roads of which the rehabilitation has already been commenced by the Program up to motorable level during the forthcoming medium term, it was observed that the program had commenced to rehabilitate 04 new roads in Gampaha District (including untouched roads) with the length of 9.02 km and the estimated cost of Rs. 321.71 million contrary to the decisions of the above committee.</p>	<p>These roads were already included in the original scope of the program. The ADB granted the Tranche 4 loan to attend only the critical works in the roads. As per the ADB guideline, these critical works were identified in roads already being rehabilitated (partially completed) as well as in untouched roads. Hence the program identified the critical works of these 4 roads because these roads were highly damaged and were not in a proper motorable condition at that time.</p>	<p>Adhere to the Committee recommendations and an investigation should be conducted on non-compliance with the Committee recommendations and new approval should be obtained.</p>