

Badulla - Chenkaladi Road Improvement Project - 2023

The audit of financial statements of the Badulla - Chenkaladi Road Improvement 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. 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 Saudi 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 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 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)	Interest had not been accounted in the financial statements as at 31 December 2023. As a result, foreign loan	348.61	Interest charges related to the Foreign Loan is recorded under separate expenditure vote assigned to the Treasury Operations Department since the loan agreement was signed by the Treasury and	Interest charges should be accounted in the Project financial statements as per State Account

		<p>the Donner Agency. Therefore, it is not recorded as expenditure in the Project Financial Statements</p>	<p>Circular No. 230/2013 dated 23 November 2013.</p>
<p>(b) 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 borrowing cost relevant to the RDA loan had not been capitalized as at 31 December 2023.</p>	<p>2.54</p>	<p>This loan was borrowed by the Road Development Authority (RDA), not by the project. Consequently, the borrowing cost is a liability of the RDA. The RDA is being accounted this borrowing cost under Work in Progress. Upon the project's completion and handover to the RDA, they will capitalize the project's cost along with the associated borrowing costs.</p>	<p>Borrowing cost should be accounted in the Project financial statements as per State Account Circular No. 230/2013 dated 23 November 2013.</p>
<p>(c) Although the Lahugala to Bibila package had been stated as terminated on mutually agreed terms, the opinion of the Attorney General is further pending on request made by the Project for mutual termination. Therefore, the accuracy of payables to the contractor since 2022 could not be ascertained in the audit.</p>	<p>35.57</p>	<p>The amount of Rs. 35.57 million is the final payment to be paid to the contractor after the Defect Liability period and after signing the supplementary agreement. This amount had been decided by the TEC after deducting the cost associated with re-bidding and procurement procedure for selecting another contractor.</p>	<p>A formal investigation should be conducted to verify the compliance of mutual termination as per conditions of the contract.</p>

- (d) The project had deposited court deposits for future obligations on the compensation of 419 lots of land after the decisions of the court. However, disclosures had not been made in the financial statements regarding those future obligations. 13.03
- The court deposits for compensation are also categorized as compensation payments. The action will be taken to disclose the same in the future financial statements as a note to the accounts.
- The disclosures on future obligations should be made in the financial statements.

2.2 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, only two Steering Committee meetings had been conducted during the year under review.	There were only two projects are ongoing in the year under review and other projects were under procurement stage. As no issues reported to discuss with stakeholder's minimum number of steering committee meeting held during the year.	Comply with 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 2023		Delay/ Audit Issue	Reasons for delays
		Expected Physical Performance (km)	Performance achieved (km)		
Highways	Road rehabilitation	146.75	128	The construction works of the road length of 18.75 km had been delayed.	Poor performance of the contractor.

Response of the Management Extension of Time has been granted for the Contract Package and delays caused by a shortage of fuel, extending the completion date to 28 December 2023. Delays due to landslides and additional work, adverse weather etc. those were the reasons for the second extension of time.

Auditor's Recommendations Maximum effort should be taken to achieve intended targets of the Project within the time frame and written instructions should be issued in the review carried out in accordance with the provisions of Section 38(1)(c) of the National Audit Act No.19 of 2018.

(ii) Land Acquisition

Component	Activity	As at 31 December 2023		Delay/ Audit Issue	Reasons for delays
		Expected physical performance No. of plots	Performance achieved No. of plots		
Land Acquisition	Registration of ownership	5,593	749	5,593 plots of lands were expected to be acquired by the project and compensation of Rs.540.67 million for 2,177 plots of lands had been paid at the end of the year under review. However, only 749	Inefficacy in land acquisition process and lack of funding.

plots of lands had been transferred to the Road Development Authority as at 31 December 2023 as per the sub clause 44 of the Land Acquisition Act and sum of Rs.166.29 million as interest due to delay the payment of compensation for the acquired land lots.

Response of the Management The registration is done only for private lots for which compensation and interest have been paid. Land registration is done by the Divisional Secretariats.

Auditor’s Recommendations Written instructions should be issued on land acquisition and compensation payments in the review carried out in accordance with the provisions of Section 38(1)(c) of the National Audit Act No.19 of 2018.

3.2 Contract Administration

The package from Lunugala to Bibile (171+800 km 190 + 800 km) had been awarded to a contractor on 12 June 2017 for a sum of Rs. 2,006.43 million and the contract period was 30 months. The contract was closed on 29 June 2021 at that time of it physical progress was at 60.32 per cent due to the poor performance of the contractor and his inability to complete the contract within the agreed time frame. It was observed that the project had paid a sum of Rs. 1,204.95 million to the contractor at the time of closing the contract. The following observations are made.

Audit Issue	Response of the Management	Auditor’s Recommendation
(i) Although the Road Development Authority had sought the opinion of the Attorney General’s Department regarding the closure of the contract with the intention of agreeing by both the contractor and the employer, it was observed that Section 15 of the General Conditions of Contract of the FIDIC Conditions do not provide provisions for ‘mutual termination’ of the contract. Thus, it was observed that the Road Development Authority had not taken action to terminate the contract as per Section 15 of the conditions of the contract and as well as the opinion of the Attorney General.	Even though, Contract provided the Termination by the Employer on poor performance of the Contractor the Employer happened not to continue with the termination because of the deviation of the performance is hard to figure out as purely by the Contractor. But all parties to the contract and the external factors such as Adverse climatic condition, Easter Sunday bomb attack and Spread of the Covid-19 pandemic etc. affect the Performance as per the report of the committee appointed by the Secretary and recommended to mutual termination. Hence, it has not been	An investigation should be conducted on deviation from the conditions of the contract and disciplinary actions should be taken as per Section II of the Establishment Code regarding losses incurred to the government.

identified clean breach of the contract by the contractor and no ground to enforce termination as per the Contract and proceed with the mutual termination as per the fact of age.

(ii) As per the above Attorney General's letter dated 17 November 2022, it was clearly stated that the non-completion of the works was due to the fault of the contractor. Although the Engineer has taken over the works which were partly completed on 12 June 2021, the project had not taken action to terminate the contract as per Section 15 of the general conditions of the contract before the expiry of the validity period of the performance guarantee ending on 31 July 2022. Therefore, the audit observed that this delay has deprived the RDA of its ability to act on contract conditions and mitigate its losses.

Even though the initial understanding as per the information available at that time seems the Contract was slow performing. However, the Employer was intended to proceed the mutual termination as recommended by the said high caliber committee after detail analysis of the case in considering holistic after the bus accident took place, problem faced by the Employer and the public with the intention to complete the road at earliest possible time.

An investigation should be conducted on deviation from the conditions of the contract and disciplinary actions should be taken as per Section II of the Establishment Code regarding losses incurred to the government.

The matters resolve mutually is the best option to solve the problem amicably as per the consequences faced without being litigation, if so re-construction get delay and the objective to complete the road and the commuters are in risk.

(iii) As per the Technical Evaluation Report on the closing of the contract by April 2022, the physical progress of the work as at the original completion date as at 25 January 2020 was 35.3 per cent and the work progress even as at the revised completion date of 23 June 2021 was only 60.3 per cent. Hence it was observed that the work done by the contractor for the last 17 months from the original completion date up to the extended completion date was only 25 per cent. Therefore, it was not clear that the actions of the RDA had recommended a 'mutual termination' instead of exercising its rights to terminate under Section 15 of the conditions of the contract.

The matter was considered holistically with the problem faced by the parties after taking considerable time and detailed analysis. The reason behind the case were quantity increase, adverse climatic condition, Easter Sunday bomb attack, Spread of the Covid-19 pandemic, etc. Accordingly, a TEC was appointed by the Secretary to look into this matter and suggest to terminate the contract with the agreement of both the Employer and the Contractor on agreed dates. Further, the same committee also emphasized that the opinion of the Hon. Attorney General on the above should be obtained.

An investigation should be conducted on deviation from the conditions of the contract and disciplinary actions should be taken as per Section II of the Establishment Code regarding losses incurred to the government.

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| (iv) | The above package had been re-bid as two packages at an estimated total cost of Rs. 2,919.56 million for the balance work by drop down the authority level from Cabinet Appointed Procurement Committee to Ministry Procurement Committee. Although the splitting is deemed necessary for legitimate reasons, it should be approved by the Procurement Committee that would have been vested with due authority to carry out such procurement prior to splitting as per Chapter 4.4.2 of the Procurement Manual, the approval of the Cabinet Appointed Procurement Committee had not been obtained for splitting the contract. | On request of the Ministry splitting into two packagers with the approval of Cabinet appointed Committee for ongoing Projects with the intention to early completion of the project, the Donor agency concurred same and accordingly procurement work proceed with the approval of the Ministry Procurement Committee (MPC) in line with procurement Manual. | An investigation should be conducted regarding non-compliance with the conditions of the Procurement Guideline and disciplinary actions should be taken as per Section II of the Establishment Code regarding the malpractices. |
| (v) | Although the Technical Evaluation Committee had recommended awarding the re-bidding packages (03B and 03C) to the selected new bidder after the mutual termination agreement was signed between the RDA and the previous contractor as per their report on December 2021, the Ministry Procurement Committee on 03 January 2022 had decided to award the balance work contracts without complying with the recommendation made by the relevant TEC and the reasons for this deviation were not revealed to the audit. | The signing of the said agreement happened to be got delayed pending opinion of the Attorney General. However the whole road section possession with the previous contractor was taken back by the RDA and no any disputed with the previous contractor too. Therefore, there is no any disputed with regards to the possession and recommended to award the Contract as the necessity to complete the section at earliest possible time in order to mitigate the issue after the condition arises with the fatal bus accident | Disciplinary actions should be taken as per Section II of the Establishment Code for responsible officers regarding discarding TEC recommendations. |
| (vi) | As per the details furnished to the audit, the cost incurred for the initial contract up to its termination was Rs.1,241.24 million and the cost estimated for completion of the entire contract was Rs.4,160.80 million. Therefore the abnormal delay and mismanagement of the contract would be directly affected to overrun the project cost considerably. Further, it was also emphasized in the | The action taken to mitigate the issued faced by the parties and the general public is the mutual termination as explained above and act accordingly. It is the best way of manage the situation. The new contracts were awarded with the most responsive lowest evaluated bid after re-bidding two contracts with the required approval of MPC, Donor concurrence | A formal investigation should be conducted regarding the whole process including the procurements and overrun the project cost uneconomically. Further, disciplinary action should be taken as per Section II of the Establishment Code regarding those |

Attorney General's letter No. BCL/44/22/RDA dated 17 November 2022 regarding this matter. and the approval of Board of the Directors of the RDA after calling the competitive bidding. discrepancies.

As per the new scope of the work to complete as requested above new bid were called in line with formal procurement procedure is the lowest cost.

3.3 Underutilized Resources

Audit Issue	Response of the Management	Auditor's Recommendation
<p>The Project had utilized only US \$ 97.58 million as at 31 December 2023 out of the total allocation of US\$ 140 million of the Project. Hence, it was observed that 30.30 percent equalling US \$ 42.42 million had remained after the completion of the original scope except the balance works of the Lunugala to Bibile road of the Project. Further, a work plan had not been furnished relating utilisation of remaining loan balance during the next few years.</p>	<p>End of 2023 OPEC disburse USD 43.87 Mn and SFD USD 34.99 Mn after completion of the original Scope of Work. Main reasons for the loan savings are due to the depreciation of the rupee value against the USD and project savings. The savings of the OFID are used for the Beragala – Wellawaya Road Project and Slope Climate Resilience Project. US\$ 12.00 Mn of SFD already transferred the Miscellaneous Foreign Aide Fund Project (MFAP) based on the Cabinet Decision. The balance savings of the SFD have being utilized for Ampara – Uhana – Maoya Project of 25Km and Chenkaladi Junction Improvement Project.</p>	<p>Maximum effort should be taken to achieve intended targets of the Project within the time frame and written instructions should be issued on fund utilization in the review carried out in accordance with the provisions of Section 38(1)(c) of the National Audit Act No.19 of 2018.</p>