

Audited Project Financial Statements

Project Number: 47273 – 003 /004 /005
Loan Number: L3171/L3221/L3222/L3325/L3326
Period covered: 01 January 2017 to 31 December 2017

SRI: Integrated Road Investment Program

Prepared by Road Development Authority, Ministry of Highways and Road Development

For the Asian Development Bank
Date received by ADB: 29 June 2018.

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கணக்காய்வாளர் தலைமை அபிபதி திணைக்களம்

AUDITOR GENERAL'S DEPARTMENT



මගේ අංකය
எனது இல.
My No.

RCT/A/IRIP/FA/2017/01

ඔබේ අංකය
உமது இல.
Your No.

දිනය
திகதி
Date

29 June 2018

The Secretary

Ministry of Highways and Road Development

Report of the Auditor General on the Financial Statements of the Integrated Road Investment Program (i - Road) Project for the year ended 31 December 2017

The audit of financial statements of the Integrated Road Investment Program (i Road) Project for the year ended 31 December 2017 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 Agreement No. 3171-Sri(SF) for tranche - 1 of 05 November 2014, Loan No.3221 and 3222 for tranche- 2 of 28 May 2015 and Loan No.3325 and 3326 for tranche - 03 of 11 December 2015 and Loan No: 3610-SRI(SF) for tranche - 04 of 15 December 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Programme, then Ministry of Higher Education and Highways, presently the Ministry of Highways and Road Development is the Executing Agency of the Project. The objective of the Programme is to enhance the road accessibility between rural communities and socioeconomic centers. The long term impact is to increase transport efficiency of national and provincial roads. As per the Loan Agreements, the estimated total cost of Programme amounted to US\$ 906 million equivalents to Rs 117,780 million and out of that US\$ 800 million equivalents to Rs. 104,000 million agreed to be provided by the Asian Development Bank under 06 Multi Tranche Financing Facility. Out of that, 06 separate Loan Agreements had been signed up to 31 December 2017 to finance US\$ 557 million equivalent to Rs.72,410 million under first 04 tranches and other Loan Agreements are expected to be signed in 2018 and 2020 to finance US\$ 243 million equivalent to Rs.31,590 million under other 02 tranches. Out of the aforementioned 06 tranches



Loan No. 3222-SRI (SF) of tranche 02 and 3326-SRI (SF) of tranche 03 had been closed on 07 April 2017 and 27 March 2017 respectively. The Program commenced its activities on 01 June 2014 and scheduled to be completed by 30 March 2024.

1.3 **Responsibility of the Management 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 as necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 **Auditor's Responsibility**

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Program's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over program management and the reliability of books, records, etc. relating to the operations of the Program.

- (b) Whether the expenditure shown in the financial statements of the Program had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Program.
- (c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Program from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Program in financial and physical terms, the assets and liabilities arising from the operations of the Program, the identifications of the purchases made out of the Loans, etc.
- (d) Whether the opening and closing balances, withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the book and record maintain by the Program and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether the withdrawals under the Loans had been made in accordance with the specifications laid down in the Loan Agreements,
- (f) Whether the funds, materials and equipment supplied under the Loans had been utilized for the purposes of the Program,
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Program,
- (h) Whether the financial statements had been prepared on the basis of Sri Lanka Public Sector Accounting Standards,
- (i) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) Whether the financial covenants laid down in the Loan Agreements had been complied with.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraphs 2.2 of this report, I am of opinion that,

- (a) the Program had maintained proper accounting records for the year ended 31 December 2017 and the financial statements give a true and fair view of the state of affairs of the Program as at 31 December 2017 in accordance with Sri Lanka Public Sector Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening balance and closing balances, withdrawal from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the book and record maintain by the Program and the balance as at 31 December 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (d) the Statement of Expenditure submitted could be fairly relied upon to support the application for reimbursement in accordance with the requirements specified in the Loan Agreements,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreements had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

A sum of Rs. 129.2 million spent to implement the activities under the Phase -11 of the Program had been shown as the Project Management cost of this Project.

2.2.2 Non-Compliance with Laws, Rules and Regulations

The Program had paid Pay As You Earn Tax amounting to Rs. 60.60 million on behalf of the Supervision Consultants of the Program, contrary to the provisions made in the Inland Revenue Act, No.10 of 2006.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to financing, budgetary provision for the year under review and the utilization of funds during the year under review and the up to 31 December 2017 are shown below.

Sources	Amount agreed for		Allocation made in	Funds utilized			
	financing in the			the Budget	during the year		as at December
	Loan Agreements		Estimate for the	under review		2017	
			year under review				
	US\$	Rs.	Rs.	US\$	Rs.	US\$	Rs.
	million	million	million	million	million	million	million
ADB	800	104,000	18,437.70	121.79	18,437.62	291.42	42,499.60
GOSL	106	13,780	400.00	-	185.20	-	442.40
Total	906	117,780	18,837.70	121.79	18,622.82	291.42	42,942.00

The following observations are made.

- According to the above information, out of total allocation of US\$ 800 million equivalent to Rs.104,000 million made by the Lending Agency, only a sum of US\$ 291.42 million equivalent to Rs.42,499.6 million representing 36.3 per cent of the total allocation had been utilized as at 31 December 2017 after lapse of 3 ½ years from the commencement of the activities of the Program.
- The detailed budget for the year under review based on the work schedule of the Program had not been prepared by the Project. Therefore, a sum of Rs.185 million had only been utilized, out of the allocation amounting to Rs.400 million made in the Budget Estimate for the year under review.

3.2 Physical Progress

According to the initial plans of the Program, the rehabilitation works of 2,200 kilometres of rural roads and 400 kilometres of national roads were expected to be implemented by the Program and it was revised in 03 times as to rehabilitate 3,108 kilometres of rural roads and 248 kilometres of national roads with the approval of the Cabinet of Ministers. However, the Program had taken action to rehabilitate 3,131 kilometres of 740 rural roads in the Southern, Sabaragamuwa, Central, North Central, North Western Provinces and Kaluthara District in the Western Province. Further, designing works of national roads had been commenced at the end of the year under review. The following observations are made thereon.

- (a) According to the Project documents, it was planned to rehabilitate 582 kilometres of 165 rural roads in the Southern Province under 09 contract packages. As per the contract agreements, all contract activities scheduled to be completed by 17 May 2017. However, only the rehabilitation works of the roads in Hambantota District under 02 contract packages had been completed at the end of the year under review with delays ranging from 03 to 05 months. Further, the rehabilitation works of the 500.03 kilometres of rural roads in the Southern province under other 07 contract packages had remained behind the targets as at 31 December 2017, due to poor performance of the contractors even after being granted time extensions to complete the works.
- (b) Out of 594.55 kilometres of 126 provincial and rural roads in the Central Province and 472.75 kilometres of 101 provincial and rural roads in the Sabaragamuwa Province scheduled to be rehabilitated by the Program by 31 December 2017, only the rehabilitation works of 453.64 kilometres of the rural roads in the Central Province and 238.72 kilometres of the rural roads in the Sabaragamuwa Province had been partially completed at the end of the year under review, due to poor performance of the contractors. Further, no information had been received on handing over of 32 rural roads of 54.39 kilometres rehabilitated in Matale District and 238.22 kilometres of the rural roads in Kegalle and Ratnapura Districts.

- (c) The progress on the rehabilitation works of 691.64 kilometres of 114 rural roads in the North Western Province under 08 contract packages had remained behind the targets and only 229 kilometres of the rural roads had been completed as at 31 December 2017. Further, the rehabilitation works of 503.34 kilometres of 115 rural roads in the North Central Province under 07 contract packages had also remained behind the targets and only 222 kilometres of the rural roads had been completed as at 31 December 2017. The physical performance of the rehabilitation works of the roads under 03 contract packages had reported very slow progress and no remedial action taken by the Programme to expedite rehabilitation works. Further, the contracts on rehabilitation works of 277 kilometres of 83 rural roads in Kalutara District in the Western Province had been awarded under 03 contract packages and out of that only 48 kilometres of the rural roads had been completed as at 31 December 2017, due to failures of the contractors.

3.3 Contract Administration

According to the information received, the contracts for the rehabilitation works of provincial and rural roads had been awarded under 42 contracts packages at an estimated cost of Rs.71,979 million. The weaknesses in contract administration such as selection of contractors without considering their financial and other resources capabilities, failures of the designs for rehabilitation works, inaccuracies of cost estimates and lack of proper supervision etc., had directly influenced to the slow progress of the road rehabilitation works. The following observations are made thereon.

- (a) It was revealed that 13 items in the work schedules for rehabilitation works of rural roads in Matara District had been revised and increased the estimated quantities of works remarkably, due to the inaccuracies in the Engineer's Estimates. Further, the cost estimates made under other 02 contract packages had been increased by Rs.352 million, due to application of unrealistic rates for cost estimates for the rehabilitation of rural roads in Matara and Hambantota Districts in the Southern Province.

- (b) The contractors engaged in rehabilitation works of roads in the Southern Province had allowed to procure equipment and other services to facilitate the Engineers deployed by the Implementing Agency and include the costs thereon in the Bill of Quantities. Therefore, a sum of Rs. 466 million had been paid to the contractors as lumpsum payments and no evidence had been received to audit to determine the nature of the facilities provided and details of the rates applied thereon.
- (c) A contractor engaged in road rehabilitation works under 07 contract packages in the 03 Provinces had failed to complete the works on due dates, due to the liquidity problems. The Program had arranged a facilitation program called ESCROW to overcome the difficulties in cash flow management and a sum of Rs. 700 million had been released to the contractor to complete the road rehabilitation works. However, a proper mechanism had not been adopted by the Program to monitor the financial plans of the contractor. Further, the evidence on concurrence of the Lending Agency had not been made available for audit.
- (d) It was observed that the mobilization advances of US\$ 270,000 had been determined with the provisional sums and contingencies of US\$ 626,030 on consultancy contract for recruitment of monitoring consultant for road management contract of national roads.
- (e) It was observed in audit that the clauses in the document for advance payment guarantee as stipulated in the paragraph 5.4.4 of the Government Procurement Guideline - 2006 had been altered and applied by the Program. Therefore, the unconditional guarantees so as to liquidate the guarantees on demand had not been obtained for all the contract packages awarded by the Program. As a result, the doubt on recoverability of mobilization advances from the unsuccessful contractors of the Program could not be ruled out in audit.

- (f) It was observed that the variation of works amounting to Rs. 38.50 million of the rehabilitation works of the rural roads in Matara District in the Southern Province awarded under the contract packages No. 02 and No. 03 had been allowed to claim under contract package No.01, contrary to the General Condition 3.1 (B) (ii) of the contract agreement.

3.4 Uneconomic Transaction


According to sub clause 4.2 of General Condition of the contract agreement, the costs such as document preparation and bank charges etc, on performance bonds presented on contract packages are required to be borne by the contractors themselves. However, contrary to the above requirement, a sum of Rs.608.50 million had been paid as at 31 December 2017 to the contractors to recover the respective costs on performance bonds, as the items in the Bills of Quantities for 42 contract packages awarded by the Program. Further, as per the confirmation received from the Licensed Commercial Banks, the actual cost in this respect was amounted to Rs. 268.70 million only. It was further observed that the attention had not been made by the Procurement Specialist and the Technical Evaluation Committee of the Program at the time of evaluation of bids.

3.5 Matters in Contentions Nature

It was observed that a local contractor engaged in rehabilitation of rural roads had unduly claimed the concessions stipulated in the Circular No. TIP/TP/08/53/2016-69 of 05 September 2016 of the Department of Trade and Investment Policy and imported machineries and other equipment valued at Rs. 324 million under tax free concessions and with the agreement of re-exporting of such machineries and equipment after completion of the road rehabilitation works. However, the Program had not adopted a proper mechanism for monitor the usage of such machineries for the intended activities stipulated in the contract package.

3.6 Issues on Financial Control

According to the information received from the Programme, commitment charges amounting to US\$ 305,203 equivalent to Rs.46.2 million had been recovered by the Lending Agency as at 31 December 2017 on undisbursed proceeds of Loans.


H.M. Gamini Wijesinghe
Auditor General