

Southern Road Connectivity Project - 2019

The audit of financial statements of the Southern Road Connectivity Project for the year ended 31 December 2019 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 2.09 of the Article II of the Loan Agreement No.3027- SRI dated 27 May 2014 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. My comments and observations which consider should be reported to the Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Project, then Ministry of Ports and Highways presently, the Ministry of Roads and Highways is the Executing Agency and Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve national transport efficiency by upgrading and rehabilitating 45.52 kilometres of the roads linked to the southern Highway. As per the Loan Agreement, the estimated total cost of the Project amounted to US\$ 95 million equivalent to Rs.12,248 million and out of that US\$ 70 million equivalent to Rs.9,025 million was agreed to be provided by the Asian Development Bank. The Project commenced its activities on 22 August 2014 and scheduled to be completed by 30 December 2018. However, the date of completion of the activities of the Project had been extended up to 30 June 2021.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019 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 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 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 Deficiency

| Accounting Deficiency | Amount Rs. million | Impact | Response of the Management | Auditor's Recommendation |
|--|-------------------------------|--|--|---|
| In terms of Para 44 of Sri Lanka Public Sector Accounting Standard No.08, the amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date. However, contrary to above requirement, the Project had made under provision amounting to Rs.17.85 million to the contractor payable account against the two interim payment certificates for the month of November and December 2019 of the contract package 02. | 17.85 | Understatement of work-in-progress account and contractor payable account. | Provision had been made based on the amount given by the consultant at the time of preparing the appropriation accounts. Work done for November and December 2019 had not been billed at the time of making the provision. Therefore, the under provision of Rs.17.85 million is accepted. | Action should be taken to follow the Sri Lanka Public Sector Accounting Standard No.08, when providing provision in the financial statements. |

3. Physical Performance

3.1 Physical Progress of the activities of the Project

| No | Component /Sub Component | As at 31 December 2019 | | Delay/ Audit Issue | Impact | Response of the Management | Auditor's Recommendations |
|-----|--|-------------------------------|----------------------|--|--|--|--|
| | | Expected physical performance | Performance achieved | | | | |
| (a) | The road construction works of Kirulapona – Homagama and Kesbewa – Pokunuwita road | 100 % | 98% | The construction activities of the contract package 2 and 4 had not been completed as at 31 December 2019. | Possibility to complete the road rehabilitation works with delays and increases the cost of the Project. | The rehabilitation works of 16.18 Km Kirulapone – Homagama Road under the contract package – 02 was completed by 29 February 2020. Rehabilitation works of 1.88 Km of Ambatale to CINEC Junction road under the contract package – 04 will be handed over once few outstanding works are completed. Delay damages were deducted for the delay. | Action should be taken to expedite the road rehabilitation activities to complete the works on targeted dates. |
| (b) | The construction works of the Ambatale CINEC Junction road. | 100% | 99% | | | | |

3.2 Contract Administration

The following observations are made.

| No | Audit Issue | Impact | Response of the Management | Auditor's Recommendations |
|-----|--|---|---|---|
| (a) | Although the revised approved contract value of the package 03 was Rs.2,056 million, the contractor certified payments had been increased to Rs.2,279.8 million by exceeding Rs.223.8 million. As result, a sum of Rs.248.6 million related to the final payment submitted on 24 June 2019 under interim payment certificate No. 29 could not be settled by the Project and had remained outstanding liability even as at 31 December 2019. Further, it was observed that interim payment application No. 30 had been submitted by the contractor on 31 October 2019 by claiming interest on delay in payment of IPC 29 above. | Possibility to increase the cost of the Project, due to increase of interest on delay payments. | As per the PPC minutes on 25 October 2018, the approval for revised contract sum of Rs.2,056 million was granted by the PPC to over the original contract sum of 1,796 million. | Action should be taken to settle the liability without delay as per contract agreement to mitigate the interest cost. |

- (b) Delay damages amounting to Rs.31.95 million recovered from the Contractor of the Package -01 had been subsequently released to contractor under Interim Payment Certificate No.16 on November 2019. However, the approval of the Consultant to release delay damages had not been given, due to non-attending the outstanding works list issued to the Contractor with the taking over certificate. Further, it was observed that performance security provided by the contractor had been expired on 13 July 2018.
- Weaken internal control system.
- EOT had been approved before release the delay damages of Rs.31.95 million (attached herewith the copy of the approval for your reference).The contractor had submitted an appeal to the secretary of Ministry of Road and Highways claiming EOT. The secretary had appointed a committee to evaluate this EOT claim and recommended the EOT and secretary approved this EOT on ex gratia basis. Performance security had been covered the construction and defects liability period of the contract. That is to be covered in the Performance Based Maintenance period as well and already informed to submit it.
- Payments condition stipulated in the contract agreement should be followed. The approvals of the Consultant should be obtained for the each and every payment for the contractor.

- (c) The construction works under 235 items in Bill of Quantities valued at Rs.134.32 million under the Contract Package -01 and the works under 198 items in Bill of Quantities valued at Rs.150 million under the Contract Package -03 had not been attended by the contractors. Thus, it indicated that the Engineer's Estimates of the contract packages were not prepared in accurate manner allowing additional advantages to the contractors on receiving mobilization advances for non-attended works valued at Rs.42.65 million.
- Possible increase of the cost of contract.
- Engineer's Estimates are prepared with the available details after site inspection and some site investigation as well as with few assumptions. However, when the work started at site there may be some deviation and some items may be need not to be attended. Some new items may be added and quantity of some existing items may be increased. Some decisions have to be taken at site with the intention of built a good quality road with less cost. Mobilization advance under the contract package – 01 and contract package – 03 were not over paid as the value of non-attended items is covered in other items in the B.O.Q.
- Need to conduct detailed Engineering studies and soil testing before preparing the Bill of Quantities.

- (d) According to the information made available, it was scheduled to acquire 3,558 plots of land including 548 plots of land owned to the Government and out of that compensation amounting to Rs.3,205.3 million for 2,590 plots of land had been paid under the Section 17 of the Land Acquisition Act. Further, the additional payments amounting Rs.1,742.47 million had been made thereon under the decisions of the Land Acquisition and Resettlement Committees. In addition, a sum of Rs.2.24 million had been paid as interest on delays in settlement of compensation up to 31 December 2019. However, no any plot had been registered under Section 44 of the Land Acquisition Act.
- Possibility to incur additional costs on compensation payments.
- The given information is correct and agreed. Payment for land compensation process is in progress for the remaining plots of lands based on the availability of fund. Due interest payment for the acquired lands had to be fully settled before register under Sec 44 of Land Acquisition Act.
- Action need to be taken by the Project to accelerate the process on completion of balance works of the land acquisition.