

## **Agriculture Sector Modernization Project - Part 01 - 2019**

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The audit of financial statements of the Agriculture Sector Modernization Project – Part 01 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 Schedule 2, Section II, B.3 of Financing Agreement No. 5873-LK dated 17 January 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. 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 Financing Agreement, of the Part -01 of the then Ministry of Primary Industries, presently Ministry of Plantation is the Executing and Implementing Agencies of the Project. The objectives of the Project are to support to increase agriculture productivity, improve market access and enhance the value addition of smallholder farmers and agribusinesses in the Northern, Eastern, North-Central, Central, and Uva Provinces. The activities of the Project are implemented under 03 components namely investment preparation support, matching grants to farmer producer organizations and agribusinesses and partial credit guarantee. As per the Financing Agreement, the estimated total cost of the Project was US\$ 106.97 million equivalents to Rs. 15,612.27 million and out of that US\$ 62.87 million equivalents to Rs. 9,175.88 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44.47 million equivalents to Rs. 6,620.39 million is expected to be financed by the beneficiaries. The Project had commenced its activities under the retroactive financing on 15 October 2016 and scheduled to be completed by 31 October 2021.

### **1.3 Qualified Opinion**

In my opinion, except for the effects of the matters described in the table 02 of my report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019, statement of expenditure and its cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

### **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 Generally Accepted Accounting Principles 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.

In preparing the financial statements, management is responsible for assessing the Project ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

## **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 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

	<b>Accounting Deficiencies</b> -----	<b>Impacts</b> -----	<b>Responses of the Management</b> -----	<b>Auditor's Recommendations</b> -----
(a)	Contribution made by the beneficiaries to implement the activities of the Project had not been separately identified and recorded	Under statement of the source of funds	Presently there is no mechanism to account the beneficiary contribution in our books as it is a 3 <sup>rd</sup> party bank transaction and a double entry cannot be passed in our books. We will take steps to raise this matter with the Treasury / Finance Ministry along with the Auditor General Department and get their views and opinion on the accounting treatment and disclose it in the financials. In our opinion this can be disclosed as a note to the accounts in the current year.	Project should identify the contribution of the beneficiaries and disclose separately in the financial statements.
(b)	A sum of Rs 2.01 million incurred to procure cutlery, water glasses, tea sets and name boards from year 2018 to 2019 had been erroneously debited to the furniture and fitting and office equipment accounts, as a results, amount of property, plant and equipment account had been overstated by the same amount in the financial statements.	Property plant and Equipment overstated in that amount	The correction Journal Entry was passed to rectify the error and financial statements were adjusted accordingly.	Action should be taken to rectify the error.

- (c) Eventhough the Rs.19.14 million had been released to four companies to carried out the activities stipulated in the agreements, subsequently the activities were abandoned, due to breech of the agreements. However, this information had not been disclosed in the financial statements as contingencies.
- The actual position of the contingencies as at 31 December 2019 had not been disclosed.
- To our knowledge there are only 2 proponents who have abandoned the projects and will do the disclosure as a note to accounts in 2020 after getting legal confirmation.
- Action should be taken to disclose this information in the Financial Statements as contingencies

## 2.2 Non- compliance with Laws, Rules and Regulations

No	Reference to the Laws Rules and Regulations	Non-compliances	Impacts	Responses of the Management	Auditor's Recommendations
(a)	Circular No: IAI/2002/02 of 28 November 2002 of the Ministry of Finance.	Computers and Accessories procured at a cost of Rs. 9.48 million had not been recorded in the Register of Computer and Accessories.	laptops and other computer accessories cannot be used for the intended purposes of the Project and facilitate to utilize for other purpose as records for the issued items were not made available in the Project office.	The details were entered in the Fixed Assets Register along with other assets and steps were taken to implement a separate register for computers and peripherals with immediate effect and records are been updated presently as per circular No IAI/2002/02 of 28 <sup>th</sup> November 2002.	Need to comply with the Circular instructions.

(b)	Stamp duty (special provision) Act No 12 of 2006	An accrued Stamp duty of Rs.25,475 which was deducted from employees' salaries from the year 2017 to up to the date of report had not been remitted to the Department of Inland Revenue and brought forward in the financial statements as payables.	Decrease in government revenue	in	The liability shown in the financials are correct and several representations were made to Inland Revenue Department but since there is no file for the line Ministry to pay Stamp Duty, ASMP payment was not accepted. Will take necessary steps to open a separate file for the project and remit it during the year 2020 and continue accordingly.	Need to comply with the regulations of the Act.
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### 3. Physical Performance

#### 3.1 Physical and Financial Progress of the activities of the Project

The activities of the Project are implemented under 3 components namely.

- (a) Investment preparation support
- (b) Awarding of matching grants to farmers producer's organizations and agribusiness
- (c) Partial credit guarantee

No	Components	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	Matching grants	(i) The matching grant program is expected to support approximately 350 farmer producer organizations in 07 priority districts of Jaffna, Mullative,	The intended benefits of the Project will not be reached to the specified farmers who identified in the Project Appraisal Document as the high poverty	Initially there were no feasible projects with large scale investments in the 7 priority districts in response to the 1 <sup>st</sup> and 2 <sup>nd</sup> EOI callings in 2017 and 2018. Currently PMU is carrying out more awareness programmes in these 7 priority districts and	Action should be taken to monitor the Project activities in order to achieve the objectives of the Project.

Anuradhapura, Batticaloa, Monaragala, Mathale and Polonnaruwa which are characterized by high poverty head counts. However the Project had selected 15 other districts including Colombo, Gampaha, Kalutara, Kurunegala to grants the matching grants. Out of the total grants, 86.6 per were allocated for these 15 other districts mentioned above.

group living in the selected areas. provincial secretaries of said districts who are the members of the Board are instructed to canvass to identify prospective investors in these districts. Already a few investors are in the pipeline.

- (ii) Eventhough the Project had approved a sum of Rs 540.32 million as matching grants to 37 proponent companies up to 31 December 2019, the matching grants had not been released even after laps of period 6 to 24 months from the dates of approval. Project will not be able to grant the allocated funds to proponents within the Project period. As a result, Treasury had to pay commitment charges to IDA on unutilized funds. This is mainly due to proponent not being able to show own contribution and commercial loans which is mainly through bank loans. The grant agreement cannot be signed unless all legal documents are produced and this is beyond PMU control. Action should be taken to monitor the Project activities in order to achieve the objectives of the Project.
- (iii) According to the information collected, the Project had Project will not be able to grant the allocated funds to This is mainly due to the nature of the project. Due to the different time periods of the projects Action should be taken to monitor the Project activities in order to achieve the objectives of

<p>granted matching grants valued at Rs. 14.63 million as a first tranche for 3 proponent companies at 31 March 2019. However, the second tranche had not been given to respective proponent companies even at the end of the year 2019.</p>	<p>proponents within the Project period. As a result, Treasury had to pay commitment charges to IDA on unutilized funds.</p>	<p>releasing of the 2<sup>nd</sup> Tranche will vary based on the work in progress in the 1<sup>st</sup> tranche of the project and further releasing of funds will not happen until the matching percentages are met. This is due to initial implementation plan of the project activities taking a longer period of time than anticipated.</p>
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| <p>(iv) According to the paragraph 8(b) vi of the annex 2 of the Project Appraisal Document, the investment proposal and matching grants would be implemented over a period of not more than two to three years, However, the approved matching grants valued Rs. 1500.25 million in the year 2017 and 2018 had not been completed the investment activities at the end of the year 2019.</p> | <p>Project will not be able to grant the allocated funds to proponents within the Project period. As a result, Treasury had to pay commitment charges to IDA on unutilized funds.</p> | <p>Depending on the size of the investment this can vary. The referred projects have not reached the stage of signing the Agreement due to nonavailability of own financing, bank loan and the relevant legal documents such as EPL/ Govt Statutory approvals, land clearance etc. According to PAD projects have to complete within 2 to 3 years. However, these approved projects have not been implemented mainly due to said reasons.</p> | <p>Action should be taken to monitor the Project activities in order to achieve the objectives of the Project.</p> |
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(v)	Even though the paragraph 8.5 of the operational manual of matching grant scheme, the PMU should maintain a list of “problem projects” and update it time to time, the list of problem project had not been maintained. Further, test checks ,carried out in audit had revealed that the matching grants only Rs. 19.14 million had been released in year 2017 and 2018 to 04 companies that are abandon their project activities and refunded only Rs. 1.35 million. In this regard the legal action had not been taken against the company by the Project to recover the balance of Rs. 17.79 million during the year under review.	Wastage of loan funds and anticipated objective could not be achieved.	The monitoring and Evaluation Specialist has maintained the list while doing the monitoring visits from implementation of the project.	Prompt action needed to rectify the situation and Early action should be taken according to the matching grant agreement.
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(b)	Partial Credit Guarantee	It was observed that the allocation of the loan amounting to US\$ 7.12 million to carry out activities under the component of Partial Credit Guarantee of the Project had not been utilized upto 31 December 2019. According to the explanations made	Implementation of the loan scheme of the proponent is affected.	The auditor’s view on Partial Credit Guarantee is factual and accepted.	Action should be taken to get the support to implement this loan scheme through Private Bank.
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by the Project several awareness programs with the representatives of Licensed Commercial Banks had been held and no action had been initiated by the respective Banks, due to problems faced in administrative arrangements.

### 3.3 Observations made on site visits

Nos	Audit Issue	Impact	Response of the Managements	Auditor's Recommendation
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(a)	The test checks carried out in audit had revealed that the progress of 13 proponent companies were not in expected level of all the activities. However, a sum of Rs 134.73 million had been released as a matching grant to these companies at the end of the year under review.	Anticipated objective could not be achieved within the Project period.	We note that certain activities get delayed from the planned implementation schedule eg. Construction, installation of machinery, technology transfer. Request the details of these 13 proponents to clarify further based on the field reports and monitoring evaluation records to give an update on the present status.	Prompt action needed to rectify the situation early according to the matching grant agreements.

### 3.4 Underutilized Resources

Nos	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	It was observed that only a sum of US\$ 13.09 million equivalent to Rs 2,135.42 million representing	Intended objective had not been	We agree with the funds amounting to Rs 2,135.42 Mn withdrawn up to 31 <sup>st</sup>	Action should be taken to monitor the Project objectives in

21.54 per cent of the total allocation of US\$ 60.77 million equivalent to Rs. 8,869.38 million made by the Lending Agency had been utilized as at 31 December 2019 after lapse of 3 years from the commencement of activities of the Project.

December 2019. However order to achieve the total allocation for objectives of the Component 1 should be Project. USD 58.63 Mn and not USD 60.77Mn and the allocation for M& E should be shared with Component 2. The low percentage in utilizing the allocated funds were due to the proponents not been able to implement the projects in the stipulated time as per the implementation schedule and there by disbursement of Grants were prolonged

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| (b) | A web – based GIS software procured by the Project in the year 2017 at a cost of Rs. 4.25 million had not been used for intended purpose over pass 03 years. | Intended objective had not been achieved. | There was a delay in recruiting the right consultant for GIS as it was hard to find the preferred person with necessary experience to carry out the required job and presently the software is used to the maximum by the new consultant who was recruited on 28 <sup>th</sup> August 2019. | Prompt action needed to rectify the situation. |
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### 3.5 Extraneous Activities

Nos	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	In contrary to the objectives of the Project, action had been taken to establish 5000 Export Villages. As an initial step, an Island wide programme of establishing 1000 villages had been commenced on 17 June 2019 at Dehiyathakandiya incurring a cost of Rs. 4.24 million on commencement programme activities	Wastage of Public funds and anticipated objectives could not be achieved.	Establishing the Export Villages was a programme done by the then Ministry of Social Empowerment and Export Agriculture. Meanwhile ASMP took the opportunity to raise awareness to identify the suitable proponents as most of the entrepreneurs were gathering at the occasion to build up stakeholder partnerships.	Need to adhere with objectives of the Project and take necessary action to minimize the operational cost of the Project.

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| (b) | A sum of Rs 2.16 million had been incurred in contrary to the objective of the Project, at the end of 31 December 2019 to organize a programme on installation of name board in the premises of beneficiaries of the matching grant. | Wastage of Public funds and anticipated objective could not be achieved with the Project period | This was done to establish the grievances re-dress mechanism as per the PAD of World Bank. The sign boards are a mode of conveying to the general public that the relevant project was approved by the State while all standards have been met and is legally viable. As a result of doing this, the residence in the surrounding area are in a position to refer any grievances faced direct to the Ministry. | Need to adhere with objectives of the Project and take necessary action to minimize the operational cost of the Project. |
| (c) | Eventhough the Project objective is to give added value to the agricultural products, an uneconomic expenditure of Rs. 3.4 million had been incurred to purchase of goats and distributed among farmers.                             | Anticipated objective could not be achieved with the Project period                             | When identifying the Gaps in value chain development in the diary sector it was revealed that the largest Gap was in Livestock and animal husbandry. The farming node is the upper stream of Value chain and to fill this gap the said project was done and this is a one time activity. The outcome of this pilot project will help the authorities on deciding the continuity of such pilot projects.        | Need to adhere with objectives of the Project and take necessary action to minimize the operational cost of the Project. |