

Financial Sector Modernization Project - 2021

The audit of financial statements of the Financial Sector Modernization Project for the year ended 31 December 2021 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 provisions in the Financing Agreement No. 6006 dated 04 October 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 the Financing Agreement, the Ministry of Finance is the Executing Agency and the Central Bank of Sri Lanka, Security Exchange Commission and Insurance Regulatory Commission of Sri Lanka are the Implementing Agencies of the Project. The objectives of the Project are to contribute to increasing financial market efficiency and use of financial services among micro, small and medium enterprises and individuals. The activities of the project are implemented under 03 components namely results based financing, investment based financing and project implementation and monitoring and front end fee. As per the Financing Agreement, the estimated total cost of the Project was US\$ 75 million equivalent to Rs. 13,125 million and entire amount was agreed to be financed by IDA. The Project had commenced its activities on 18 October 2018 and scheduled to be completed by 31 December 2022.

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 2021, statement of expenditure and its cash flow for the year then ended in accordance with Sri Lanka 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 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. Physical Performance

2.1 Physical progress of the activities of the Project

Component	As at 31 December 2021		Audit Issue	Reasons for delays
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	Expected physical performance	Performance achieved		
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Component - 01	13 Disbursement Linked Results (DLR)	04 Disbursement Link Results	Thirteen (13) activities had been planned to be implemented under this component. Out of the activities which had been supposed to complete in the year 2021, three (3) activities had not been completed and six (6) activities had not been commenced as at 31 December 2021.	Delay in implementation.

Component - 02	Strengthening the Organization Capacity of three regulatory institutions	Under this component, 22 projects were planned to be implemented. However, 06 projects were cancelled and 02 projects had not been commenced up to end of the year under review.	Delay in implementation.
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Response of the Management Agree with the observation and most of the activities in both component 01 and 02 listed as not completed or not started as at 31 December 2021 were included in the loan cancellation letter on 17 February 2022.

Auditor's Recommendation It is required to take necessary action to achieve all targets as intended.

2.2 Unutilized Resources

No	Audit Issue	Response of the Management	Auditor's Recommendation
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(a)	Total estimated cost of the Project was US\$ 75 million, equivalent to Rs. 13,125 million. Out of that Rs. 1,371.44 million or US\$ 7.23 million representing 9.6 percent of the estimated cost had been utilized by 31 December 2021 after laps of three years from the commencement of the project.	Mainly due to most of the procurement activities were done according to the international competitive bidding method and those activities were highly affected in the last two years, due to Covid 19 pandemic situation in the country.	Action should be taken to utilize the total allocated funds.
(b)	According to the Government Debt Accounting System in Department of External Resources, US\$ 179,698 equivalent to Rs.35.6 million had been paid to the Lending Agency as commitment charges on undisbursed loan amount.	-Do-	Action should be taken to minimized the unnecessary commitment charges by using the funds as scheduled.