

Agriculture Sector Modernization Project – Part 02 -2022

The audit of financial statements of Agriculture Sector Modernization Project – Part 02 for the year ended 31 December 2022 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 the 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 the Financing Agreement, the Ministry of Agriculture is the Executing and Implementing Agency of the Agriculture Sector Modernization Project – Part 02. The objectives of the Project are to support to increase agriculture productivity, improve market access and enhance value addition of smallholder farmers and agribusinesses in Jaffana, Vavuniya, Anuradhapura, Batticaloa, Badulla, Monaragala, and Polonnaruwa districts. Further, the activities for the support for smallholder farmers to produce competitive and marketable commodities, improve their abilities to respond to market requirements and move towards commercialization are expected to be carried out under the Agriculture Sector Modernization Project – Part 02. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 64.87 million equivalent to Rs. 9,175.88 million agreed to be provided by the International Development Association. In addition, Euro 25 million equivalents to Rs. 5,040 million had been received from the European Commission Trust Fund to implement the activities in other districts such as Kandy, Ampara, Kilinochchi and Vavunia. The Project commenced its activities on 01 January 2017 and scheduled to be completed by 31 December 2021 then extended up to 31 December 2024.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the 2.1 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 2022, 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.

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

Accounting Deficiency	Amount Rs. million	Responses of the Management	Auditor's Recommendation
The credit balance of the World Bank/IDA of US\$ 32.6 million as at 31 December 2022 had not been translated in to LKR value of the reporting date and as a result the loan balance and project expenditure balance shown in the statement of financial position had been understated by Rs.5,827 million.	5,827	The Funds received by CBSL from the World Bank by way of Disbursements are converted to LKR at the exchange rate prevailed at the date of disbursements. Similarly, the funds released to the Project by CBSL as withdrawals are converted at the exchange rate prevailed at the time of withdrawals.	Financial Statements should be prepared in accordance with the accounting policy followed by the project

2.2 Non-compliance with Rules and Regulations

Reference to the Rules and Regulations	Non Compliances	Responses of the Management	Auditor's Recommendations
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka			
(i) F.R.756 and 757	The appointment of the Annual Commodity Survey Board should be done on or around December 15 of every year. Annual commodity Survey Board had not been appointed due date. Reports of Board of survey have not been submitted to the audit. Furthermore, PMU office has not conducted an annual commodity survey for the year of 2022.	The comments of the Auditor General are admitted. The Board of Surveys was appointed and verifications for all provinces except the Head office were conducted. Due to pressure of works does not involve it. It is, however, wish to report that most of the office furniture had been provided by the Ministry and they have been inventoried in the Books of the Ministry and a team of Board of survey had verified the assets released to the Project.	Need to adapt with instructions given in the financial regulation.

(ii)	F.R. 835	The Project rented two buildings during the year for PMU office. without takeing valuation report for buildings.	The comments of the Auditor General are admitted	Need to adapt with instructions given in the financial regulation.
(b)	Circular No 01/2022 dated 07 February 2022 issued by the Department of Management Audit	Project Internal Audit Committee meeting had been held during the year under review.	The Comments of the Auditor General are admitted. Action will be taken to conduct Audit committees from the 3rd quarter of 2023.	Need to adapt with instructions given in the circular.
(c)	Circular No 01/2019 dated 15 March 2019 issued by the Department of Management Services	Project Steering Committee (PSC) meeting should be held once in two month. However, only three Project Steering Committees had been held during the year under review.	The Comments of Auditor General are admitted. Despite every attempts were made to conduct Project Steering Committee Meetings as planned, few meetings could not be conducted due to reasons beyond the control.	Need to adapt with instructions given in the circular.

3. Physical Performance

3.1 Physical and Financial Progress of the activities of the Project

The activities of the Project are implemented under 5 components namely

- (a) Farmer training and Capacity Building
- (b) Modern Agriculture Technology Parks (ATDP)
- (c) Production and Market Infrastructure Development
- (d) Analytical and Policy Advisory Support
- (e) Project Management, Monitoring and Evaluation

The Project Development Objective are to support increasing agriculture productivity, improving market access, enhancing value addition of smallholder farmers and agribusiness in the Project areas. According to that whole objective of the Project is to empower the farmers, create employment, attracting youth to modern agriculture. Even though a sum of Rs.302.9 million had been paid as interest charges to the Lending Agency by the Government of Sri Lanka it was observed in audit the original Project objectives had been differed. Following observations are made thereon.

Components	Audit Issues	Responses of the Management	Auditor's Recommendations
(a) Farmer Training and Capacity Building	(i) Office equipment valued at Rs.35 million had been purchased for the purpose of distribution to the companies which are expected to converted public unlisted company of 20	The Comments of Auditor General are admitted. In terms of section 9(a) of the project Appraisal Document (PAD), the Project can assist the	Actions must be taken to adhere with objectives mentioned in the Project Appraisal Document in order

	<p>cluster projects and 20 pilot projects that have not been started by 31 March 2021. Only a part of the purchased goods had been received by the project and the undelivered goods were also paid for without checking whether the requested quantities had been correctly supplied in accordance with the relevant contractual specifications.</p>	<p>Farmer Companies (Public Unlisted Companies) providing basis office equipment. Accordingly, it has been decided to procure office equipment valued at Rs.35,372,436 for those companies.</p>	<p>to achieve the objectives of the Project.</p>
	<p>(ii) By 30 June 2023, 21 companies have been registered for the Pilot Project and 18 companies out of them have not been started business operation activities. Furthermore, 4 companies have not available office premises. It is problematic to the audit whether those objectives would be able to achieve in next one and half year.</p>	<p>The comments of Auditor General are admitted. Some Companies have already commenced their business operations and rest of the companies are in the processes of commencing their operations.</p>	<p>Efforts should be made to achieve the relevant goals within the operational period of the project.</p>
<p>(b) Modern Agriculture Technology Parks</p>	<p>(i) The Central Provincial Project Office had spent an amount of Rs.168.2 million to provide planting materials and farming equipment to establish a group of 300 beneficiaries of dried chillies in the Kurunduwatta area of Gampola. Due to the fact that the number of farmers who could participate in the project was 177, the equipment purchased for 123 people had become an idle expense.</p>	<p>The comments of Auditor General are admitted. It was planned to establish this chilli Cluster with 300 farmers. Accordingly, action was taken to procure the inputs required for the planed cultivation. This was required due to reason that the inputs should be available to the farmers at the time of cultivation. However, the situation prevailed in the country such as the scarcity of fuel, chemical fertilizer etc. had caused to discourage the farmers for cultivation. However, there are 240 farmers are presently involving with the cultivation.</p>	<p>Funds should be used efficiently and effectively.</p>

- (ii) According to the project proposal, 300 farmers are expected to grow chillies on half an acre each, and to produce 450 tonnes of dried chillies from 03 tonnes per acre, and to earn Rs.270 million by selling 1 kg at Rs.600. The total number of farmers who cultivated and abandoned cultivation is 177. It was not possible to contribute 123 farmers to the project.
- It is agreed that the beginning stage, there were lesser farmer participation and now 240 farmers are engaging with the cultivation and which will be further increased in the next season.
- The tasks of the project should be planned and implemented so that the desired goals can be achieved.
- (iii) Due to the inability to find a plain land in the hilly areas like in the North Central Province where chillies are widely cultivated, the chillies had been destroyed by rainwater and floods due to the Helmalu method and having to find half an acre of land in several places. And also, the use of pumps and the drip system were disabled. Although a chilli drying machine was installed in Kurunduwatta area, the use of the drying machine had also failed due to the fact that the farmers carrying chillies had to travel a distance of 13-40 km from the farm to reach the drying machine.
- This area is suitable for Chilli Cultivation. Two crops from this cultivation have already been harvested. As far as other areas where chilli is cultivated are concerned this area is also compatible for chilli cultivation.
- project should be planned and implemented so that the desired goals can be achieved.
- (iv) It was planned to provide farming equipment to 300 farmers, and equipment worth Rs.173 million had been purchased before the farmers were identified. The number of identified farmers was 177 and the farm equipment valued Rs.71 million purchased for 123 farmers were useless.
- Since the Procurement of the Project needs to be done obtaining the approval of the World Bank through STEP and following the competitive Bidding Procedure for which a considerable time is required. In addition, the cultivation processes should be commenced within the season. In view of this situation, procurements for agriculture equipment
- project should be planned and implemented so that the desired goals can be achieved.

cannot be delayed until the farmer selection is finalized. Since most of the farmers have been selected and commenced cultivation, the issue in idling of assets will not arise.

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| (v) | When physical inspection of farming equipment purchased for distribution to farmers, there was a surplus of 213 Galvanized (GI) pipes, a shortage of 177 rolls of Insect Proof, a shortage of 139 water pumps, a shortage of 07 Foot Valve and a shortage of 12,105 Nursery rays and a shortage of 2.8 kg of chilli seeds. As receives and issues of beads and spirals were not recorded, it was not possible to identified deficiencies and excesses. | The excess of stocks has been due to the fact that some beneficiary farmers had failed to take over the respective items at that time. However, the assets have been issued to the farmers. | F.R.751 should be followed in relation to project inventories and stocks. |
| (vi) | Out of the 20 cultivated lands that were physically checked, except for one plots, the farmers in the remaining 19 cultivated lands had not used the goods provided by the project. Those 19 cultivated lands had failed due to floods, rain or cold weather. | Action will be initiated to take back the un-used equipment from the farmers and will be re issued to new farmers willing to join with the project. | The tasks of the project should be planned and implemented so that the desired goals can be achieved. |
| (vii) | The hybrid maize seed production project was started in Kandaketiya area of Badulla district with an estimated cost of Rs. 90 million which was implemented on the aid of the European Union. 50 farmers and 50 acres of paddy land owned by farmers were taken over for this project. The project had failed completely due to non-selection of farmers as per the project criteria, non-selection of right | Comments of the Auditor General are admitted. As this area is famous for Maize cultivation and as recommended by the consultants, the Hybrid Maize Seed Production Cluster in Kandeketiya area was started. It has now been decided to shift this cluster Ampara District. | The tasks of the project should be planned and implemented so that the desired goals can be achieved. |

cultivation land, non-identification of suitable seeds for cultivation land, non-delivery of seeds, fertilizers and agro-chemicals within due time. The amount of Rs.2.67 million incurred had been an idle expenditure.

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| (viii) | Although Rs.28.4 million was spent on the moringa project consisting of the estimated cost of Rs.32 million and 100 beneficiaries, the cultivation of moringa was not successful due to the use of foreign seed sources instead of local sources as moringa seeds. Accordingly, the expenditure of Rs.28.4 million incurred had become useless. | The comments of Auditor General are admitted. The Covid Situation the attitudes of farmers, drawback of business due to the economic environment were the main contributory factors for the failure in the Moringa Cultivation in Wellawaya. It has been reported that farmers are gradually re-engaging with the Moringa Cultivation together with other Inter Crops. | The tasks of the project should be planned and implemented so that the desired goals can be achieved. |
| (ix) | The North Central Provincial Project Office had purchased 11,600 galvanized pipes for distribution to farmers under the Chilli Cluster Village Programme. Out of them, only 9,600 galvanized pipes were received as per Goods Receiving Notes (GRN). The 2,000 galvanized pipes had not been received by the warehouse and payment had been made for the said 2,000 pipes. | It has been reported that the entire quantity of Galvanized Pipes have been delivered by the supplier. | Project activities should be planned and executed so as to achieve the desired goals and F.R. 751 should be dealt with in relation to project inventory and stocks. |
| (x) | The pilot project of Mushrooms, Aloe Vera, Drumstick and Bitter gourd where executed in Anuradhapura district has been spent the expenses respectively as Rs. 13.517 million, Rs. 23.77 million, Rs. 32.497 million and Rs. 11.9 million. Therefore, the | The Mushroom Cultivation is now being Implemented. The Buyers for Aloe vera Could not be found during the Covid period as such the farmers discouraged this cultivation. However, actions now have been | Project tasks must be properly planned and executed. |

total expense was Rs. 81.7 million. However, the farmers involved in all those pilot projects have left the farming activities due to lack of proper technology and market. Therefore, the expenditure incurred for the above farming had been idled.

3.2 Contract Administration

Audit Issues	Responses of the Management	Auditor's Recommendations
(a) The Agriculture Sector Modernization Project had started on 17 January 2017 and it has been taken about 22 months till 15 November 2018 for creating Monitoring Information System (MIS). On 15 November 2018, the contract was awarded to a private company for the value of Rs.8 million and according to the contract agreement, it was stated that a complete Monitoring Information System (MIS) should be provided for the project within 03 months from the date of signing the contract. This information system was not fully completed until December 2022 and the amount of Rs. 5 million spent was an idle expenditure.	<p>The Comments of Auditor General are admitted. However, action has been taken by the Provinces to enter Provincial Action Plans from 2022 and accordingly, they updated their programs. Due to other involvements, the provincial staff had no adequate time available to attend this task. The Project, therefore, decided to recruit Social and Environmental officers on contract basis for every district. In addition to their assigned works, they were also being assigned to update the MIS regularly.</p> <p>As the result of this arrangement, the provincial actions plans for the year 2023 are being updated to the system. Furthermore, targets have been given to them to complete the entering of Beneficiary Data.</p>	The project should work to achieve the desired objectives within the relevant period.

- (b) Due to non-implementation of projects within a specified period of time without proper planning and due to the fact that the Ministry of Agriculture and the Ministry of Primary Industries had made agreements to implement the project together, but they were implemented as two projects, 22 projects worth Rs.517 million which were to be completed before 31 December 2022 had the physical progress ranged from 0 percent to 50 percent .
- Comments have not been made by the management. The project should be implemented as planned.

3.3 Underutilized Resources

Audit Issue	Responses of the Management	Auditor's Recommendations
(a) Budgeted contribution of GOSL fund for the project is Rs. 40 million, the Project had utilized of GOSL fund only Rs.8.9 million and it is equivalent to 23 percent of agreed amount. Therefore, 77 percent has not been utilized for the Project.	The comments of Auditor General are admitted. A sum of Rs.40 Million was provided under Vote 118-02-03-39-2507(17) to effect the payments related with the Government Agencies and for the Government officers. The majority of payments were made under Loan/Grant Funds and considering the budgetary situation and fiscal constraints of the country, every attempt were made to expenditure under this allocation to a minimal level.	Project activities should be implemented as planned.
(b) According to the information an amount of US dollars 6.2 million or Rs.904.89 million was allocated for the farmer training and capacity building programs of the project. Out of this amount of Rs.132 million had been spent by September 2022. The aim of implementing these training programs was to create farmer-related production associations. At the end of the training, the project officers had withdrawn from the contact and monitoring activities with the farmers in the cluster projects. As a result, the farmers had withdrawn from the pilot groups of this project and	Training activities of farmers are continuously being done. Some of the Pilot Projects have been scaled up under ISP programme. Furthermore, 21 number Public Un-listed companies were established for Pilots projects.	Project activities should be implemented as planned.

the amount of Rs. 132 million incurred for farmer training and capacity development had become an idle expenditure.

3.4 Matters in Contentious Nature

Audit Issue	Responses of the Management	Auditor's Recommendations
(a) A procurement plan was not prepared for the procurement activities carried out by the project's regional office. As per the procurement guideline 8.9.1 in relation to procurement of goods through National Competitive Bidding (NCB) and Shopping Method has not entered into an agreement with the supplier. The files related to the purchases did not include information on performance security and as per 5.4.10 of the procurement guidelines performance security or some percentage of the contract value should be retained but no such retention was made in respect of 11 contracts amounted as Rs.473.378 million. Also there was no documentation in the procurement file that the goods were supplied or accepted as per the agreed standards.	Comments have not been made by the management.	The procurement of the project should be done as per the procurement guidelines code.
(b) Before selecting the beneficiaries of the Nawalapitiya Chilli Cultivation Project, equipment had been purchased for distribution to 300 farmers. By the end of September 2022, there were 86 beneficiary farmers who had not received the equipment in three farmer organizations and the agricultural centre. There were 380 of polythene cover rolls worth Rs.32.224 million in idly at the premises of Deputy Project Office in Matale due to the purchase of polythene cover roll without selecting the specific number of farmers.	Comments have not been made by the management.	Project tasks must be properly planned and executed.
(c) A stock of goods and equipment worth Rs.178.4 million purchased for distribution to farmers related to banana cultivation in Batticaloa district and chilli cultivation in Ampara district have not been distributed to the farmers. Those goods and equipment were available at Kaludevali Economic Center and Wellandi Divisional Secretariat and Komari Agriculture Centre.	The respective cultivations have now commenced and the equipment referred to therein is being distributed.	Procurement of goods and services should be done in accordance with the procurement guidelines in a manner that maximizes benefits to the government and utilization of assets should be efficient.

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| (d) | <p>Before carrying out the procurement work in the case of providing and installing sprinkler water systems valued Rs.6 million for Thalawa banana cultivation projects, the specifications and plans should be prepared by a suitable person with professional knowledge and experience and approved by the appropriate authority. There was no written evidence that it was done formally. There were cases where one member of the Procurement Committee and one member of the technical evaluation committee did not sign the relevant reports.</p> | <p>The Sprinkler Irrigation System referred to the Audit Report had to be procured as a temporary measure to be used for the Chilli Cluster in Thalawa as the nom availability of recommended irrigation systems due import restrictions. One the recommended irrigation systems are procured, the sprinkler irrigation system will be issued to the PUC for the use of other use of alternative crops.</p> | <p>Before carrying out the procurement activities, the specifications and plans should be prepared by a suitable person with professional knowledge and experience and approval of the appropriate authority should be obtained.</p> |
| (f) | <p>In the procurement of 23 electronic scales valued Rs 23 million a formal estimate and specifications were not prepared and quotations were not called as per Section 2.14 of the procurement guidelines. Furthermore, failure to enter into an agreement on bid securities and warranty period and by paying Rs. 247,667 more than the price of the local agent due to non-quotation from the local agencies has been incurred a loss by the Government.</p> | <p>Comments of Auditor General are admitted.</p> | <p>Efficiency and transparency of government procurement procedures should be ensured.</p> |

3.5 Issues Related to Human Resources Management

	Audit Issue	Response of the Management	Auditor's Recommendations
(a)	<p>The post of Deputy Project Director at Head Office (PMU) was vacant from 16 December 2021 to December 2022 and the officer who holds the position of Policy Specialist of the project was appointed for acting of the duty. Approximately Rs.575,000 was paid as acting allowances during that period</p>	<p>The comments of Auditor General are admitted. The officer concerned was appointed for acting the vacant post of Deputy Project Director. Applications were invited from the interested parties and yet no recruitment was made due to the situation prevailed in the country during this period. Furthermore, a decision was taken by the government to fill the vacant positions of project staff from the government officers. Accordingly, the officer appointed on acting basis had to be continued until an officer was released from the ministry for this post. Accordingly, this post has now</p>	<p>Vacancies should be filled promptly and the project's goals should be achieved.</p>

been filled by an officer released from the Ministry of Agriculture. The officer responsible for the area of Analytical and Policy Advisory support had performed her responsibilities and furthermore, review of policies was made during the year with the stakeholders.

- (b) The main duty assigned to the Policy Specialist was the analytical and policy advisory support and the declaration of the policies identified by the project under the component as the national policy and the implementation of the necessary ancillary measures had not been completed even by December 2022. When arranging the agreement for the relevant policy formulation, Rs. 65.58 million had been paid and the payment had been an idle expenditure.
- Implementation of the project as two components under Ministry of Agriculture and the Ministry of Plantation Industries has been based on a decision of the Cabinet of Ministers and the World Bank. However, not only both components work very closely but the project Director of Component 01 continuously served until recently as Steering Committee member of the Component 02. Furthermore, several Buy -Back Agreements have been entered by the Clusters implemented under Component 02 with the Agribusiness companies supported by the Component 01 to ensure a reasonable price for the products.
- Analytical and policy advisory support and formulation of policies identified by the project under the component as national policy and work to implement necessary supporting measures.
- (c) An employee had been recruited for 02 years on the basis of monthly payment of Rs.70,000 to the Central provincial offices without considering the minimum qualifications mentioned in the bidding documents for the recruitment of Social Mobilizer of the project and without calling for applications at once. Agreements were made to pay Rs.1,680,000 for those 02 years. The projects had also failed to verify the qualifications presented by the service provider.
- The comments of Auditor General are admitted.
- The Social Mobilizer was selected through calling quotations and having believed that the documents furnished by him were correct, the respective assignment was awarded the concerned individual. Soon after knowing that he had furnished forged documents, the service contract with him was cancelled.
- After this situation, all Provincial Deputy Directors were advised the necessity of maintaining diligence and due care in scrutinizing and verifying Bidding Documents.
- It should be ensured that the certificates submitted while recruiting employees for the project are correct.