

Poverty Alleviation Micro Finance Project -II and Poverty Alleviation Micro Finance Project - II Revolving Fund - 2013

The audit of financial statements of the Poverty Alleviation Micro Finance Project - II and Poverty Alleviation Micro Finance Project -II Revolving Fund for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the comprehensive income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, 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 (3) of Article III of the Loan Agreement No.SL-P94 dated 29 July 2008 entered into between the Japan Bank for International Cooperation (JBIC) and the Government of the Democratic Socialist Republic of Sri Lanka (GOSL).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Poverty Alleviation Microfinance Project-II, the Central Bank of Sri Lanka is the Implementing Agency of the Project. The objectives of the Project are to improve income level of the poor and enhance an inclusive formal financial service for them by providing credit for income generating activities, improving management and training capacity of Participating Financial Institutions (PFI's) and Partner Agencies (PA's) and increasing income generating opportunities and skills development of beneficiaries, thereby contributing to alleviating poverty, mitigating regional inequity and supporting peace building. According to the Loan Agreement, the estimated total cost of the Project is Japanese Yen 2,759 million and out of that Japanese Yen 2,575 million was agreed to be financed by the JBIC and Rs. 372 million was agreed to be financed by the Government of Sri Lanka as counterpart funds. According to the request made by the Project Director in 2013 through Director General of External Resources, the Japan International Cooperation Agency had given the concurrence to reallocate the funds in accordance with Sub section 1 of Section 2 of Schedule 2 of the Loan Agreement.

The Project commenced its activities in January 2009 and was scheduled to be completed by December 2013 according to the Section 3 of Schedule 1 of the Loan Agreement. However the period of the Project had been extended up to 12 November 2015.

1.3 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

2. 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 consistent with International Standards of Supreme Audit Institutions (ISSAI 1000-1810). 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 judgement, including the assessment of the risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project'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 Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by 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 audit opinion. The examination also included such test of systems and controls, transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

- (a) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identification of purchases made out of the Loan, etc,
- (b) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement,
- (c) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the project,
- (d) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project,
- (e) Whether the opening and closing balances, withdrawals from and replenishments to the Special Yen Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (f) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (g) Whether financial covenants laid down in the Loan Agreement had been complied with.

3. Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Poverty Alleviation Micro Finance Project - II and Poverty Alleviation Micro Finance Project -II Revolving Fund as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

- (a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with the Sri Lanka Accounting Standards,
- (b) the funds provided had been utilised for the purposes for which they were provided,
- (c) the opening and closing balances, withdrawals from and replenishments to the Special Yen Account during the year ended 31 December 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (d) the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement,
- (e) 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 Agreement had been complied with.

4. Financial Statements

4.1 Financial Performance

According to the financial statements and information made available, the total Project expenditure for the year ended 31 December 2013 amounted to Rs. 261,487,585 as compared with the expenditure of Rs. 732,089,815 for the previous year. A summary of the expenditure for the year under review, the previous year and the cumulative expenditure as at 31 December 2013 are shown below.

Description	Expenditure for the year		Cumulative Expenditure as at 31 December 2013
	2013 Rs.	2012 Rs.	Rs.
Credit-Refinance to Participatory Financial Institutions	201,521,500	651,357,800	2,880,070,300
Equipment	-	13,831,039	13,831,039
Interest and Commitment Charges	18,740,103	18,914,439	58,585,531
Administration Expenses	41,225,982	47,986,537	157,051,627
Total	261,487,585	732,089,815	3,109,538,496

In terms of Section 2 of Schedule 1 of the Loan Agreement, the total estimated allocation of the Project for the period of 2008 - 2013 amounted to Japanese Yen 2,572 million. However, the total disbursements as at 31 December 2013 amounted to Japanese Yen 2,149 million which was 84 per cent of the total allocation. Out of the above allocation Japanese Yen 2,100 million had been allocated for credit and the actual utilization amounted to Japanese Yen 2,099 million as at 31 December 2013 which represented 99.95 per cent. The expenses incurred under the Consultancy Services and Capacity Development Component (JPY 30.8 million) had reimbursed by Japan International Cooperation Agency in 2014. Hence, a reallocation was made in January 2014 by allocating Japanese Yen 205 million from unutilized credit in the Consultancy Services and the Capacity Development Component.

4.2 Special Yen Account

According to the financial statements and information made available, a summary of the transactions relating to the Special Yen Account maintained by the Central bank of Sri Lanka for the year under review is shown in the following statement.

	Japanese Yen	Rs.
Balance as at 01 January 2013	Nil	Nil
Add: Replenishments	96,838,244	126,275,956
Foreign Exchange Gain/(Loss)	-	(2,789,303)
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	96,838,244	123,486,653
Less: Withdrawals	69,306,668	89,185,062
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Balance as at 31 December 2013	27,531,576	34,301,591
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4.3 Revolving Fund Account

According to the Section 4 (1) of Article III of the Loan Agreement, a Revolving Fund Account had been opened with the Central Bank of Sri Lanka in August 2011. Refinance disbursements from this account had commenced in 2013 and the amount of refinance loans amounted to Rs. 956 million had been granted during the year under review.

5. Audit Observations

The following observations are made.

5.1 Non - compliance with Laws, Rules, Regulations and Management Decisions

According to the Operating Instructions of the Project, Project Steering Committee should meet once in three months at the Central Bank of Sri Lanka to determine and consider the policy matters relating to the Project implementation. However, only one Project Steering Committee meeting had been held during the year 2013.

5.2 Revolving Fund of the Project

Although refinance recoveries of the Project had commenced from 2010, Poverty Alleviation Micro Finance Project -II Revolving Fund Credit Scheme had commenced its operations only in 2013 for a period of five years up to 14 July 2018.