

## **Community Livelihoods in Conflict Affected Areas Project (Re - awakening Project) - 2013.**

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The audit of financial statements of the Community Livelihoods in Conflict Affected Areas Project (Re - awakening Project) for the year ended 31 December 2013 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 4.01 (b) (i) of Article IV of the Development Credit Agreement No. 3935 CE dated 23 July 2004 as amended by Agreement dated 25 September 2007 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the International Development Association (IDA). Subsequently, the Second Financing Agreement No. 4671 LK dated 11 January 2010 and the Third Financing Agreement No.4956 LK dated 29 November 2011 had been entered into between the GOSL and the IDA for providing additional financing for this Project.

### **1.2 Implementation, Objective, Funding and Duration of the Project**

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According to the Financing Agreements of the Project, the Ministry of Economic Development is the Implementing Agency of the Project. The objective of the Project is to help the conflict affected communities in the Northern and Eastern Provinces and the adjoining areas to restore livelihoods, enhance agricultural and other production and income and building capacity for sustainable, social and economic reintegration. As per the Financing Agreements, the estimated total cost of the Project is US\$ 156.89 million and out of that US Dollar 124.70 million or 88.35 per cent was agreed to be financed by the International Development Association (IDA). The GOSL and beneficiaries had agreed to finance sums of US Dollar 13.72 million and US Dollar 2.72 million respectively. The Project commenced its activities on 23 July 2004 and was scheduled to be completed by 31 December 2014.

### **1.3 Responsibility of the Management for the Financial Statements**

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The Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles. This responsibility includes; designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate

accounting policies, and making accounting estimates that are reasonable in the circumstances.

## **2. Scope of Audit and Basis of Opinion**

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My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on review of the financial statements presented to audit and substantive tests of samples of transaction. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitation of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates made by the management in the preparation of financial statements as well as evaluating their overall presentation. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I, therefore, believe that my audit provides a reasonable basis for my opinion. The examination also included such tests of systems and controls, transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over the Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) 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 Credit etc.
- (c) Whether withdrawals under the Credit had been made were in accordance with the specification laid down in the Credit Agreements
- (d) Whether funds, materials and equipment supplied under the Credit had been utilized for the purposes of the Project.

- (e) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (f) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (g) Whether the opening and closing balances, withdrawals from and replenishments to the Special (Dollar) 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 (CBSL) as at that date.
- (h) Whether the Statements of Expenditure (SOE) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Credit Agreements.
- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and;
- (j) Whether the financial covenants laid down in the Credit Agreements had been complied with.

### **3. Opinion**

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So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 5 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2013 in accordance with Generally Accepted accounting principles,
- (b) the funds provided had been utilized for the purpose for which they were provided,
- (c) the withdrawals from and replenishments to the Special (Dollar) 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 Credit Agreements,
- (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 Credit Agreements had been complied with.

#### 4. Financial Statements

##### 4.1 Financial Performance

According to the financial statements and information made available for audit, the expenditure of the Project for the year ended 31 December 2013 amounted to Rs. 2,836,561,233 and the cumulative expenditure as at 31 December 2013 amounted to Rs. 14,293,598,505. The expenditure incurred during the year under review, and the preceding year and the cumulative expenditure as at 31 December 2013 are summarized below.

Activities	Expenditure for the year ended 31 December		Cumulative Expenditure as at 31 December 2013
	2013	2012	
	Rs.	Rs.	Rs.
Civil Works	2,143,597,249	2,966,078,625	7,440,823,920
Goods and Equipment	2,528,865	28,559,725	367,535,597
Consultancy Services	108,934,967	162,015,760	873,291,364

Incremental Cost	146,122,106	190,425,231	1,069,265,005
Expenses met on Sub-grants	435,378,046	747,023,085	4,286,744,475
Flood Damage	Nil	Nil	255,938,144
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Total	<u>2,836,561,233</u>	<u>4,094,102,426</u>	<u>14,293,598,505</u>

#### 4.2 Special (Dollar) Account

According to the financial statements and information made available, the operations of the Special (Dollar) Account during the year under review are summarized below.

	US \$	Rs.
Balance as at 01 January 2013	8,391,543	1,067,075,280
Add: Replenishments	15,404,279	1,988,468,365
Foreign Currency Gain	—	26,942,559
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Less: Withdrawals	23,795,822	3,082,486,204
	18,461,417	2,384,996,782
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Balance as at 31 December 2013	<u>5,334,405</u>	<u>697,489,422</u>

#### 5. Audit Observations

##### 5.1 Accounting Deficiencies

According to the Ledger Accounts maintained by the Project relating to Third Financing Agreement (No.4956), the total expenditure incurred under civil works amounted to Rs. 4,430,277,516. However, it was brought to the financial statements as Rs. 4,430,159,470. The difference on total expenditure incurred under civil works amounting to Rs. 118,046 had not been explained for audit.

#### 6. Financial and Physical Performance

##### 6.1 Utilization of Funds

(a) Certain significant statistics relating to the financing of funds, budgetary provision for the year under review, utilization of funds during the year under review and the cumulative expenditure as at 31 December 2013 are shown below.

Source	Amount agreed to be financed		Allocation made in the Annual Budget	Amount utilized during the year under review		Amount utilized as at 31 December 2013	
	USD Mn	Rs Mn		USD Mn	Rs Mn	USD Mn	Rs Mn
IDA Agreement Nos:							
3035	75.00	7,450	576	5.17	568.45	61.05	6,715.15
4671	12.35	1,358	132	1.20	131.89	12.13	1,334.03
4956	54.98	6,048	1,992	18.11	1,991.71	42.11	4,632.27
GOSL	14.56	1,372	135	1.22	134.27	10.94	1,203.43
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Total	156.89	16,228	2,835	25.69	2,826.32*	126.23	13,884.88*
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\* These amounts were not agreed with the amounts shown in the paragraph 4.1 of the Report due to inclusion of beneficiary contribution and the accounting treatments made for accrued expenses.

(b) According to the information made available, funds allocated for each Project activity and expenditure incurred thereon up to 31 December 2013 are given below.

Activity	Funds Allocated as per Project Agreements		Expenditure incurred up to 31 December 2013	
	US\$	Rs.	US\$	Rs.
Civil Works	59,608,488	7,786,361,295	59,403,003	7,440,823,920
Goods and Equipment	2,593,927	338,831,820	2,450,272	367,535,597
Consultancy Services	6,413,130	837,728,464	5,930,556	873,291,364
Incremental Cost	3,447,315	450,305,813	3,225,880	1,069,265,005
Sub-grants under Agreement:-				
No.3935	33,530,998	4,379,988,060	26,674,773	3,285,125,659
No.4671	6,844,687	894,087,541	6,859,365	799,503,831
No.4956	<u>15,685,502</u>	<u>2,048,919,340</u>	<u>2,778,188</u>	<u>202,114,985</u>
<b>Total</b>	<b><u>128,124,047</u></b>	<b><u>16,736,222,333</u></b>	<b><u>107,322,037</u></b>	<b><u>14,037,660,361*</u></b>

\* Expenditure incurred out of the GOSL contribution is not included

The following observations are made in this regard.

- (a) The main activity of the Project is to provide essential support for people whose livelihoods were affected by the floods. However, out of funds amounting to Rs. 2,049 million allocated as Sub - grants for livelihood support activities under the Third Financing Agreement No. 4956, only a sum of Rs. 363 million or 18 per cent of the total allocation had been utilized for the intended purposes.
- (b) Even though a sum of Rs. 1,455,403,200 had been allocated under the First Financing Agreement as Sub - grants for infrastructure development activities as per Chapter III of the Community Manual, a sum of Rs. 2,050,065,282 had been spent for those activities up to 31 December 2013. Accordingly, the actual cost incurred for respective purposes had exceeded the allocation by Rs. 594,662,082.
- (c) It was observed that a sum of Rs 31,819,663 had been spent by this Project to carry out activities required to be completed under other Project called Emergency Northern Recovery Project (ENREP).

## 6.2 Physical Performance

### 6.2.1 Physical Progress of the Project Activities

#### (a) Village Rehabilitation and Development Activities

According to the Action Plan prepared for the year 2013, particulars relating to the activities to be carried out during the year under review and activities completed as at 31 December 2013 are given below.

	Activities to be carry out under		Activities Completed as at 31 December 2013		Activities to be completed as at 31 December 2013 as per	
	First Financial Agreement	Second Financial Agreement	First Financial Agreement	Second Financial Agreement	First Financial Agreement	Second Financial Agreement
	Nos.	Nos.	Nos.	Nos.	Nos.	Nos.
Infrastructure Development Activities	2,414	1,027	2,120	949	294	78
Sub Loans on Livelihood Support	159,888	57,333	94,627	19,988	65,261	37,345

The following observations are made in this regard.

- (i) The construction works to be carried out under infrastructural development activities had shown a slow progress despite the activities of the Project is expected to be closed on 31 December 2014.
- (ii) The Project had planned to grant 159,888 loans to beneficiaries from the Revolving Fund under First Financing Agreement, However, only 94,627 loans representing 59 per cent of the total allocation had been granted up to 31 December 2013. Further, the Project had planned to provide 57,333 loans from the Revolving Fund under Second Financing Agreement, However, only 19,988 loans representing 35 per cent of the total allocation had been granted up to 31 December 2013. According to the explanation made by the Project Director, the



targets had been made on tentative basis and actual beneficiaries had been selected for providing loans through the viability of the business proposals.

**(b) Cluster Level Livelihood Development Activities**  
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According to the Action Plan prepared for the year 2013, particulars relating to number of activities targeted during the year under review and activities completed as at 31 December 2013 are given below.

	Activities expected to be carried as per Action Plan	Activities Completed as at 31 December 2013
	----- Nos.	----- Nos.
Village Development Organization Clusters	}	17
Mini Clusters	}	29
Family Economic Enhance Package Clusters	}	17
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	<u>114</u>	<u>63</u>

The following observations are made in this regard.

- (i) Out of the total cluster activities completed up to 31 December 2013, no any activity had been completed in the Ampara District, which was one of the mostly conflict affected District in the Eastern Province. According to the Project Director, no viable proposal were received from PMU at Ampara. Hence, the target could not be achieved.
- (ii) According to the progress reports, two activities had been completed in the Trincomalee District, However, the physical inspection carried out on 11 June 2014 had revealed that those two activities were remained at the initial stage due to delay in receiving power supply for such activities.

(c) **Civil Works and Rehabilitation Works carried out for Flood Damages**  
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Details relating to target of activities stipulated in the Action Plan - 2013 and activities completed as at 31 December 2013 are given below.

Components -----	Activities expected to be completed as per Action Plan -----	Activities Completed as at 31 December 2013 -----
<b>Civil Works</b>		
Minor Tanks	144	101
<b>Flood Damage Rehabilitation</b>		
Livelihood Restoration Activities (poly net houses)	3,026	988
Rehabilitation of Small Scale Irrigation Schemes	273	183
Rehabilitation of Rural Roads	620	546
Rehabilitation of Drinking Water Scheme	96	53

The following observations are made in this regard.

- (i) Even though it was planned to rehabilitate 144 village tanks up to 31 December 2013, only 101 tanks had been rehabilitated as at that date. According to the Project Director, other 43 civil works were remained in progress.
- (ii) Even though it was targeted to complete 3,026 livelihood restoration activities up to 31 December 2013, only 988 activities had been completed as at that date due to design failures of the activities.

**6.2.3 Contract Administration**  
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(a) **Procurement of Climate Smart Agriculture (CSA) Poly Net Houses**  
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It was observed that a program for constructing of 3,000 poly net houses had been implemented by the Project for agricultural purposes and out of that 428 poly net houses had been constructed as at 31 December 2013 in 10 districts. The following observations are made in this connection.

- (i) Eventhough the main objective of the Project is to help the conflict affected communities and villages in Northern and Eastern Provinces by restoring their livelihood and enhancing agricultural production, any poly net house had not been constructed in Jaffna and Mullativu Districts
- (ii) The Project Director has instructed to the Deputy Project Directors in each district to follow tender procedure to select a suitable supplier to procure the above mentioned poly net houses. However, only one private company had been selected for all 10 districts to supply and install above mentioned 428 poly net houses without considering the manufacturing capacity of the supplier and its' past experience in this field.
- (iii) Although payments should be made only after the procuring of poly net houses in required quality and provision of agreed services, it was observed in audit in certain instances that the payments of each poly net house amounting to Rs. 85,000 had been released without fulfilling such requirements. Such instances are described as follows.
- A sum of Rs 3,276,000 had been overpaid for 300 poly net houses which were deviated from the required specifications.
  - According to the estimate prepared by the PMU, a sum of Rs. 9,000 had been allocated for a farmer to provide other material and equipment to implement the agricultural activities. However, physical verification made thereon had revealed that such material valued at Rs. 216,000 had not been provided to 24 farmers in Polonnaruwa District to implement the agricultural activities.
  - Further, sprinkler system valued at Rs. 3,000 per poly net house had not been provided for 14 farmers in Anuradhapura District. Value of such sprinkler system was Rs. 49,000.
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**(b) Procurement of Arch Shaped Poly Net Houses**  
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In addition to the above, the Project had awarded a contract in 2011 to procure 1,200 poly net houses. The following observations are made in this connection.

- (i) According to the agreement entered into with the contractor, it was agreed to supply 1,200 arch shaped poly net houses at a cost of Rs.155,595 for the farmers in Central Province. However, different rates had been paid for 73 such poly net houses supplied for the farmers in Matale and Kandy districts amounting to Rs.158,486 Rs.159,694 respectively. As a result, a sum of Rs. 242,451 had been overpaid.
- (ii) It was observed that neither a feasibility study nor procurement procedures had been followed for the procurement of poly net houses. As a result, a sum of Rs. 16,327,284 had to be paid for extra works as the arch shaped poly net houses procured for one district was not environmentally suitable for other districts.
- (iii) Further, a sum of Rs. 1,761,020 had been paid to a third party during the year under review to repair the arch shaped poly net houses even though the defects liability period was not over at the time of payments made for repairs.

**(c) Contract for supplying Soil for Construction**  
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According to the Bill of Quantities prepared for the construction of bunds of nine tanks, separate rates had been included for excavation, transport and other cost to use soil from outside locations. However, the contractor had used soil excavated from the Tanks itself and used for the construction of Bunds of the Tanks. Further, the total BOQ amount of Rs. 44,881,497 had been paid to the contractor without considering the transporting excavation cost of soil from outside premises.

**(d) Utilization of Funds Allocated for Quality Control**  
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Even though a sum of Rs. 2,109,000 had been allocated in the estimates for quality testing for construction 12 tanks, only a sum of Rs. 114,318 had been spent for 06 Tanks. Balance funds amounting to Rs. 1,994,682 had not been utilized for intended purposes.

**(e) Rehabilitation of Provincial Road and Re-construction of Irrigation Systems**  
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Physical inspections on activities carried out on rehabilitation of provincial roads and reconstruction of irrigation systems carried out under the Project had been made in several instances and the deficiencies observed during the course of audit are described below.

- (i) Even though the Paburana Sungawila Road had been constructed at a cost of Rs. 22,258,620, it was observed at the physical inspection carried out on 17 March 2014 that Lankapura Pradesha Sabha, had refused to take over the road as there were several pot holes on the surface of the road.
- (ii) According to the estimates prepared for construction of Unakatu Oya Anicut, a sum of Rs. 604,539 had been estimated for supplying and fixing of a water control gate along with the gear box. However, the contractor had claimed an additional amount of Rs. 244,200 per gear box and a total cost of Rs. 1,465,200 had been spent by the Project for that purpose.
- (iii) Extra works under the construction of Perappankadu Anicut valued at Rs. 623,876 had been carried out on fixing 11 rubber water seal for 11 water control gates of the Anicut, as the size of the gates included in the drawings prepared by the Engineer was less than the required size.
- (iv) A sum of Rs. 416,665 had been paid to a private consultancy firm for preparing drawings for the construction of a bridge across the Minneriya Oya at Raja Ela . According to the drawings, the width of the bridge should be 5.9 meter. However, the width of the bridge constructed by changing the drawings prepared by the consultancy firm was 4.15 meter. As a result, a

sum of Rs. 416,665 spent for preparing the drawings had become a fruitless expenditure.

- (v) A sum of Rs. 150,000 had been spent by the Project for clearing light jungle in an area of 1.2 hectare in spill approach area for the Rehabilitation of Kimbulagala Tank. However, the contractor had cleared only 0.50 hectares of jungle area and as such a sum of Rs. 87,500 had been overpaid.

#### **6.2.4 Matters in Contentious Nature**

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Following observations are made

- (a) According to part III of the Finance Act, No.05 of 2005 Construction Industries Guarantee Fund Levy (CIGFL) should have been deducted and remitted to the Commissioner General of Inland Revenue on contract value if the contract value was more than Rs.15 million. However, CIGFL amounting to Rs. 5,355,921 had not been deducted from 80 contracts for which value of the contract had exceeded Rs.15 million.
- (b) The contract for improvement of two roads from Parakkramapura junction to Kobbekadawa junction and Kobbekadawa junction to Sampathunarm had been awarded at of Rs. 31,552,232 and Rs. 46,512,985 respectively. However, the contract for the above mentioned improvement works had been terminated after one year from the date of awarding contract and making payments aggregating Rs. 23,808,727 as the improvement works had been redesigned and awarded to another contractor under the funds provided by the Emergency Northern Recovery Project (ENREP) Project. As a result, a sum of Rs. 23,808,727 spent by the project funds had become a fruitless expenditure.
- (c) A contract for rehabilitation of Udukudala Anicut across Neeththaiaru at Sagamam in Ampara District had been awarded on 21 August 2012 for a contract value of Rs. 15,908,588. However, these rehabilitation works had been terminated on 11 February 2014 after paying a sum of Rs. 2,915,367 to the contractor as there

was no access to the work site due to the cultivation activities. As a result, a sum of Rs. 2,915,367 spent from the project funds had become a fruitless expenditure.

- (d) A contract had been awarded on 05 September 2011 for filling and spreading of gravel on the surface of the road at a length of 3.9 Km and placing concrete on the road at a length of 1.55 Km for a sum of Rs. 16,516,120. The contractor had abandoned the works on 25 August 2012 and the Project had paid a sum of Rs. 6,853,381 to the contractor as the contractor had completed 40 per cent of the works. However, the Project had to enter into an agreement with another contractor for a sum of Rs. 27,403,423 to complete the balance works. Therefore, the Project had to pay a sum of Rs. 17,740,684 additionally to complete the entire works as the Project had not properly evaluated the bids submitted by the bidders before awarding the contract.
- (e) The Project had awarded a contract for providing vehicle to the Engineer for supervision activities for a period of 7 ½ months at the rate of Rs. 125,000 per month subject to maximum usage of 2500km per month. However, the same contractor at the same period had agreed to provide vehicle for another construction work at the rate of Rs. 50,000 per month subject to the same condition. Therefore, the project could have saved a sum of Rs. 562,500 if the vehicle had been hired at the rate of Rs. 50,000 per month.

## **6.5 Granting of Loans under Micro Finance Scheme**

The Project had implemented the Micro Financing Scheme to enhance the living condition of the villagers. Particulars relating to district wise performance of the Micro Finance Scheme are given below.

District	No of Focal Villages	Loan provided from Project Funds Rs.(Mn.)	Loan provided from Revolving funds Rs.(Mn.)	Outstanding Loan Balances Rs.(Mn.)	Amount of Bad Debts Rs.(Mn.)	Percentage of Bad Debts as a Percentage of Loan provided
Ampara	56	74.0	75.9	61.0	5.8	8
Batticaloa	60	75.0	141.8	60.4	8.7	12
Trincomalee	51	82.0	119.9	79.6	11.9	15
Vavuniya	97	114.0	119	93.5	25.6	22
Mannar	88	115.0	195.9	64.0	9.4	8
Jaffna	73	103.0	157.2	80.1	9.5	9
Kilinochchi	62	83.0	68.3	47.2	11.1	13
Mullaitivu	89	71.0	91.8	62.9	17.0	24
Anuradhapura	70	83.0	173.5	83.3	13.5	16
Polonnaruwa	50	72.0	110.8	67.1	7.6	11
Puttalam	51	71.0	130.5	65.6	6.6	9
Moneragala	55	90.0	99.3	79.7	2.7	3
<b>TOTAL</b>	<b>802</b>	<b>1,033.0</b>	<b>1,483.90</b>	<b>844.40</b>	<b>129.40</b>	

The following observations are made in this regard.

- (a) The Project had implemented Micro Finance Scheme in 237 focal villages during period from 2005 to 2008 under the First Financing Agreement and a sum of Rs.183 million had been granted as sub loans for 8,935 beneficiaries. However, the Project had not taken any action after the year 2008 to monitor the loans granted to the above mentioned beneficiaries. Accordingly, it was obvious that the Project had given opportunities to the beneficiaries to misappropriate the project funds.
- (b) Out of the funds allocated for each District under the Micro Finance Scheme, considerable amount of project funds had remained as Bank balances, outstanding loan balances and bad debts. Therefore, the funds allocated under the Micro



Finance Scheme had not been fully utilized for the purposes for which they were provided. Instances observed in some districts are given below.

District	Loan granted from Project Fund	Cash Balance	Bank Balance	Amount of Bad Debts	Present Value of the assets of the Fund
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	Rs.(Mn.)	Rs.(Mn.)	Rs.(Mn.)	Rs.(Mn.)	Rs.(Mn.)
Vavuniya	114.0	2.0	25.0	25.6	126.5
Mannar	115.0	0.6	42.1	9.4	106.1
Jaffna	103.0	1.5	28.0	9.5	109.6
Kilinochchi	83.0	1.1	36.8	11.1	85.2
Mullaitivu	71.0	1.3	20.7	17.0	84.9

- (c) Loan Outstanding from the project funds and recovery funds as at 31 December 2013 represented over 40 percent of the total loan granted in Ampara, Vauniya and Monaragala districts and the loan outstanding in other nine districts had represented over 20 per cent of the total loans granted in those districts.
- (d) Provision for bad debts had represented over 20 per cent of the total loans granted as at 31 December in Vavuniya district.