

Pro-Poor Economic Advancement and Community Enhancement (PEACE) Project (Component A) - 2013.

The audit of financial statements of the Pro-Poor Economic Advancement and Community Enhancement (PEACE) Project (Component A) for the period of 06 months ended 30 June 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(7) of the Article III of the Loan Agreement No. SL-P77 dated 26 March 2003 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Japan Bank for International Co-operation (JBIC), presently known as Japan International Co-operation Agency (JICA).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Pro-Poor Economic Advancement and Community Enhancement (PEACE) Project, the Ministry of Irrigation and Water Resources Management is the Implementing Agency of the Project. The objectives of the Project are to, reduce poverty, increase farmers' productivity and achieve sustainable agricultural development through rehabilitation of irrigation facilities, income generating activities etc; in the North Western, North Central and Central Provinces in Sri Lanka. According to the Loan Agreement, the estimated total cost of the Project is Rs.5,040 million and out of that Rs.2,509 million was agreed to be financed by the Japan Bank of International Co-operation (JBIC). The Project commenced its activities on 06 October 2005 and was completed by 22 May 2013.

1.3 Responsibility of the Management for the Financial Statements

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

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 transactions. The scope and extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitations 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 test 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 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 the purchases made out of the Loan, etc.
- (c) Whether withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (d) Whether the funds, materials and equipment supplied under the Loan 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 Imprest Fund Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 30 June 2013 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (h) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report and
- (i) Whether the financial covenants laid down in the Loan Agreement had been complied with.

3. Opinion

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 period of 06 months ended 30 June 2013 and the financial statements give a true and fair view of the state of affairs of the Project as at 30 June 2013 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the withdrawals from and replenishments to the Imprest Fund Account for the period of 06 months ended 30 June 2013 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 30 June 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) 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 expenditure of the Project for the period under review amounted to Rs. 119,694,748 as compared with the expenditure of Rs. 584,292,445 for the year ended 31 December 2012. A summary of the expenditure for the period of 06 month under review, expenditure for the preceding year and the cumulative expenditure as at 30 June 2013 is given in the following statement.

	Expenditure for the period of 06 months ended 30 June 2013	Expenditure for the year ended 31 December 2012	Cumulative Expenditure 30 June 2013
	----- Rs.	----- Rs.	----- Rs.
Fixed Assets	24,880,500	18,800,000	436,373,608
Vehicles	3,604,220	-	105,760,919

Work-in-Progress	-	220,374,486	-
Training and Capacity Building	-	18,295,560	430,440,316
Consultancy Services	-	10,605,290	978,498,884
Civil Works, Surveying and Constructions	91,210,028	316,217,109	4,471,352,910
Total	119,694,748	584,292,445	6,422,426,637

4.2 Imprest Fund Account

According to the financial statements and information made available, the operations of the Imprest Fund Account during the period under review, and the balance as at 30 June 2013 are summarized below.

	Year 2013	
	JPY.	Rs.
Balance as at 01 January 2013	15,159,446	22,434,464
Replenishments	63,566,942	85,407,065
Foreign Exchange Loss	-	(3,847,680)
	78,726,388	103,993,849
Less :		
Withdrawals During the period	77,878,765	102,880,496
Balance as at 30 June 2013	847,623	1,113,353

5. Audit observations

5.1 Accounting Policies

Provision for payables as at 30 June 2013 related to telephone bills amounting to Rs. 14,512 had not been brought to account.

5.2 Accounting Deficiencies

The following accounting deficiencies were observed.

- (a) The net cash flows from Investment Activities during the year under review amounted to Rs. 95,975,528. However, it was shown in the cash flow statement as Rs.59,093,227. Therefore, net cash flows from Investment Activities had been understated by Rs. 36,882,301. Further, cost on investments amounting to Rs. 119,694,748 did not agree with the balance amounting to Rs. 95,975,528 shown in the cash flow statement.
- (b) The balances aggregating Rs. 230,812,254 did not agree with balance shown in the Statement of Investment Cost submitted by the Ministry of Irrigation and Water Resources due to erroneous accounting practices.

5.3 Lack of Evidence for Audit

The following documentary evidence was not made available for audit.

Item	Value	Evidence not made available
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	Rs.	
Fixed Assets (Project Coordinating Office and Project Management Unit - Anuradhapura)	484,877,148	Verification Reports at the end of the period. Receipt orders (General 219) for distributed assets.
Designing and Printing of 1000 Brochures for the Project.	192,500	Stock Certificates and Issue Orders (General 141).
Purchasing of Fixed Assets (01 Generator and 06 Water Bowsers)	25,132,500	Original Paying Vouchers.

	510,202,148	
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6. Financial and Physical Performance

6.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provisions for the year under review and utilization of funds during the year under review and the cumulative expenditure as at 30 June 2013 are shown below.

Source	Amount agreed to be financed		Allocation made in the Annual Budget	Amount utilized during the period under review	Amount utilized as at 30 June 2013
	J.Yen Mn	Rs. Mn.	Rs. Mn	Rs. Mn	Rs. Mn
JICA	2,785	2,509	-	102	5,625
GOSL	2,809	2,531	-	17	797
Total	5,594	5,040	-	119	6,422

No Provision had been made for the project in the Annual Budget of the Ministry of Irrigation and Water Resources Management for the year 2013. However, provision of Rs. 78,000,000 had been transferred to the Project from other Votes during the period under review. According to the financial statements submitted to the audit total expenditure incurred during the period under review, amounted Rs. 119,694,748. Therefore, a total excess of Rs. 41,694,748 was observed.

6.2 Physical Performance of the Project

The following observations are made.

- The Department of Irrigation had undertaken to complete 09 major scale irrigation schemes, 09 medium scale irrigation schemes and 80 minor scale irrigation schemes under the Project. Although a sum of Rs. 19,087,575 had been spent on civil works during the period under review, the civil works carried out could not be ascertained in audit due to lack of an annual work plan for the period under review and the financial and physical progress reports.
- The Ministry of Irrigation and Water Resources Management, had entered into agreements with Rajarata Development Bank and Wayamba Development Bank on 05 August 2008 to implement the credit programme within the Project area. The main objective was to provide assistance to income generation activities of villagers and farmer organizations in the project area. According to the credit programme agreement, a sum of Rs. 82,000,000 had been allocated for this purpose.

The following observations are made.

- (i) According to the information made available, Wayamba Development Bank had granted loans valued at Rs. 80,585,000 through its 6 Branches in the area and only a sum of Rs. 21,703,120 had been recovered.
- (ii) Information relating to Rajarata Development Bank as at 30 June 2013 had not been provided to audit.
- (iii) It is observed in audit that the installments of loans valued at Rs. 3,508,980 as at 31 December 2013 had remained outstanding and legal action had not been taken against the defaulters by the relevant Banks to recover the balance amounting Rs. 2,793,761.

6.3 Matters of Contentious Nature

The following observations are made.

- (a) The Project Office in Anuradhapura had been operated in a building owned by a private party obtained under an annual rent amounting to Rs. 1,350,000 from October 2011 to March 2013. However, according to the valuation report issued in 2009 the monthly rent was determined as Rs.37,500 and as such as over payment amounting to Rs.675,000 had been made for 18 months period. The Project Office continued to occupy the building up to 30 June 2013 without extending the rent agreement.
- (b) A Generator and 06 Water bowsers valued at to Rs. 2,352,000 (inclusive of value added tax amounting to Rs. 252,000) and Rs. 22,780,500 respectively had been procured by the Project at the end of the project period. However, the reason for that not been explained to audit to justify such procurement at the closing stage of the Project. Further, it was observed that such assets were handed over to "Niraviya" farm of Mahaweli Authority. In addition, 05 Poultry layer sheds had been constructed at a cost of Rs.8,513,972 in 2012 and sum of Rs.1,973,876 had been spent for the renovation of dairy factory at Niraviya farm during the year under review. However, the activities of the Niraviya farm did not come under this Project.
- (c) Payment of Rs. 4,233,702 had been made during the period under review for some constructions, and improvements of Rajanganaya model farm and Nachchaduwa Nature Park which were not related to the activities under the Project.

6.4 Winding up Activities of the Project

Project winding up plan had not prepared until 31 August 2014. However, a sum of Rs. 25,420,885 had been incurred between 01 July 2013 to 31 December 2013 by the project.

The following observations are also made.

- (a) The assets including vehicles, machinery, laboratory and survey equipment, etc. procured at a cost of Rs. 484,877,148 had been handed over to various Government Agencies at the completion of the Project. However, documentary evidence such as lists of assets taken over, vehicle registration books, etc. had not been submitted to audit in support of takeover of the assets by those Government Agencies.
- (b) According to the information made available to audit 23 vehicles had been distributed among the Government Agencies. However, such vehicles had not been included in the list which was furnished to audit along with the financial statements.
- (c) Although 46 motor bicycles had been handed over to the Rambewa Workshop of Department of Irrigation, reasons for handing over of motor bicycles were not explained.
- (d) The fixed assets distributed among the Government Agencies could not be compared with the financial statements due to unavailability of the values in the distribution list provided by the Project.
- (e) Seven Bank Accounts had not been closed down even up to 31 December 2013 although the project activities had been completed as at 30 June 2013.
- (f) A Fuso cab and chassis with freezer and dairy unit had been purchase at a cost of Rs. 7,300,000 and Rs. 15,675,310 respectively for the Niraviya farm of the Mahaweli Authority which did not under the activities of the Project.

7. Systems and Controls

Special attention is needed in respect of the following areas of control.

- (a) Accounting
- (b) Winding up Process
- (c) Control over Credit Programme
- (d) Distribution of Fixed Assets