

## **Smallholder Plantation Entrepreneurship Development Programme -2015**

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The audit of financial statements of the Smallholder Plantation Entrepreneurship Development Programme for the year ended 31 December 2015 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 Article V of Loan Agreement No. 712 - LK dated 08 May 2007 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the International Fund for Agricultural Development (IFAD).

### **1.2 Implementation, Objectives, Funding and Duration of the Programme**

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According to the Loan Agreement of the Programme, the Ministry of Plantation Industries is the Executing Agency and Implementing Agency of the Programme. The objectives of the Programme are to (a) strengthen the beneficiaries' institutional capacity and negotiations skills (b) improve the land tenure status of smallholder tea and rubber growers (c) increase producers' profits through improved post-harvest handling, storage, processing and marketing of their products (d) develop and expand rural finance and credit services and (e) ensure that women improve their living conditions and reduce their time poverty. As per the Loan Agreement, the estimated total cost of the Programme was US\$ 29.22 million equivalent to Rs. 3,827.82 million and out of that US\$ 22.5 million equivalent to Rs. 2,954.05 million was agreed to be provided by the International Fund for Agriculture Development. The Programme commenced its activities on 06 November 2007 and scheduled to be completed by 31 December 2016.

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

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Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles 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.

### **1.4 Auditor's Responsibility**

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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 and the International Fund for Agriculture Development Guidelines for Project Audits. 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 judgment, 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 Programme'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 Programme's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the 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 opinion. The examination also included such tests 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 Programme management and the reliability of books, records, etc. relating to the operations of the Programme.
- (b) Whether the expenditure shown in the financial statements of the Programme had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Programme.
- (c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Programme from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Programme in financial and physical terms, the assets and liabilities arising from the operations of the Programme, the identifications of the purchases made out of the Loan, etc.
- (d) Whether the opening and closing balances and 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 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (f) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Programme.

- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Programme.
- (h) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.
- (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 Loan Agreement had been complied with.

## **2. Financial Statements**

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### **2.1 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, I am of opinion that,

- (a) the Programme had maintained proper accounting records for the year ended 31 December 2015 and the financial statements give a true and fair view of the state of affairs of the Programme as at 31 December 2015 in accordance with Generally Accepted Accounting Principles and the IFAD Guidelines,
- (b) 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,
- (c) the opening and closing balances and 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 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,
- (d) the funds provided had been utilized for the purposes for which they were provided,
- (e) the 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.

## 2.2 Comments on Financial Statements

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### 2.2.1 Accounting Deficiency

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The civil works and other fixed assets valued at Rs. 378.24 million procured by the Programme up to 31 December 2015 had been shown under the Programme Expenditure instead of shown separately as non-current assets.

### 2.2.2 Non - Compliance with Laws , Rules and Regulations

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Annual Board of Survey on Plant, Property and Equipment of the Programme had not been carried out for years of 2014 and 2015 as required by the Financial Regulation 756.

## 3. Financial and Physical Performance

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### 3.1 Utilization of Funds

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Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2015 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
IFAD	22.55	2,954.05	350.60	2.24	304.67	18.76	2,229.21
GOSL	3.76	492.56	49.40	-	32.09	-	181.26
Participating Financial Institution Beneficiary Contribution Wellassa Rubber Company	1.90	248.90	15.85	-	21.15	-	106.12
	1.01	132.31	30.00	-	43.48	-	176.29
	-	-	-	-	-	-	2.00
	<b>29.22</b>	<b>3,827.82</b>	<b>445.85</b>	<b>2.24</b>	<b>401.39</b>	<b>18.76</b>	<b>2,694.88</b>

### **3.2 Physical Progress**

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The activities of the Programme had been carried out in 07 Divisional Secretariat Divisions in Kandy, Nuwara-eliya and Kegalle districts in mid country area and 08 Divisional Secretariat Divisions in Monaragala District for the purposes of community development, use of lands, promoting value addition for products of rural community and promotion of credit facilities for enterprises in rural areas. The following observations are made.

- (a) A sum of Rs. 23.86 million had been spent to construct 30 rubber processing centres in Monaragala District and out of that, construction works of 12 centres had been completed as at 31 December 2015. However, the production of rubber sheets had been commenced in 03 centres only during the year under review. The community participation for the construction of rubber processing centres was remained unsatisfactory due to low market price on rubber products and allocation of farmers' time for paddy harvesting activities in the Maha season.
- (b) The site visits made by the auditors in March 2016 had revealed that 12 wells constructed in Monaragala District to provide drinking water at a cost of Rs. 2.44 million had not been used for intended purposes due to inferior quality of water for drinking purpose.
- (c) The program for providing of subsidy for rubber small holders in 08 Divisional Secretariats in Monaragala District expected to be completed in 2013 had been continued up to 31 December 2015 and subsidies valued at Rs. 499.06 million had been granted as at 31 December 2015. It was observed that new plantations in 435 acres of lands owned to 323 smallholders were not successful due to climate changes and fire occurred in drought seasons. The subsidies of Rs. 15.72 million had been granted thereon.
- (d) A Concessionary Loan Scheme had been implemented for the rural community on income generating activities under the Rural Finance and Credit Component of the Programme. Out of the total disbursement of Rs. 140.11 million under 158 sub loans made as at 31 December 2015 by 06 Participatory Financing Institutions in mid country area, disbursement of Rs. 63.98 million under 87 sub loans had been granted by a single Licensed Specialized Bank. In addition, Government owned Licensed Banks had provided 140 sub loans, out of total sub loans of 158 granted as at 31 December 2015 indicated that no priorities given by the Licensed Banks in private sector to implement the Loan Scheme. Further, it was observed that the Loan Scheme is administered by the Central Bank of Sri Lanka and no proper mechanism had been established by the Programme to

ascertain whether the sub loans are granted to the intended beneficiaries of the Programme.

- (e) Out of a concessionary loan of Rs 7.5 million allocated to a tea factory in Kothmale under the Loan Scheme implemented by the Programme for refurbishment of tea factories, only Rs 4.3 million had been utilized and prospective rehabilitation works were abandoned subsequently.
- (f) The Programme had established 243 Community Entrepreneur Groups and 248 Savings and Credit Groups in 54 Grama Niladhari areas in the Central Province and 15 Grama Niladhari areas in Sabaragamuwa Province. However, the risk on continuation of the operations of such community organizations could not be ruled out in audit. According to the Annual Report - 2015 of the Programme, 37 Community Entrepreneur Groups and 27 Savings and Credit Groups were subjected to independent audits and out of that, only 19 Community Entrepreneur Groups and 14 Savings and Credit Groups were confirmed on sustainability of their operations.

### **3.3 Contract Administration**

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The following observations are made.

- (a) The Project Sub Office at Monaragala had taken action to distribute imported hybrid maize seeds to the farmers of the Monaragala District and the Technical Evaluation Committee had recommended to procure 02 types of seeds thereon. However, the entire requirement of 3,500 kilograms of seeds had been procured at a cost of Rs 3.39 million from the variety of SA 501 seeds with quoted at higher cost and no seeds from low cost variety of BISI 222 had been procured.
- (b) The activities implemented by the Programme to mark the forest conservation buffer zone in Monaragala District had shown slow progress. It was observed that 345 boundary pillars had been erected as at 31 December 2015, out of 1500 boundary pillars were expected to be established even though advances of Rs 01 million had been released during the year under review.
- (c) A private company had been awarded a contract at cost of Rs 2.43 million to select the beneficiaries to provide grants upto Rs.50,000 each for self employment purposes by strengthening of Village Rural Rubber Clusters in Monaragala District and grants aggregating Rs. 5.82 million had been released to 120 beneficiaries during the year under review. It indicated that administration

cost of the grant was 41.6 per cent which remained high. According to the explanation made by the Project Director, the service providing company was not only involving in selection of beneficiaries but also strengthening of Village Rubber Development Clusters, entrepreneurs, and trade organizations and exploring of future market opportunities.

### **3.4 Issues relating to the financial controls**

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It was observed that the financial controls over granting of subsidies from the Sub-office of the Small Planter Entrepreneurs Program in Monaragala were not satisfactory. The Accountant of the Department of Rubber Development who was responsible to handle the periodical advances to the Programme had also acted as the Accountant of the Regional Office of the Department in Monaragala and also as the certifying officer for payment of subsidies made by the Programme Sub -Office.

### **3.5 Idle / Under utilized Assets**

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The following observations are made.

- (a) It was observed that 02 stalls, out of 03 stalls of the building constructed at a cost of Rs 1.52 million at Maduraketiya for sale of agricultural products in the area had remained idle without utilizing for intended purposes.
- (b) The equipment procured in 2014 at a cost of Rs. 4.55 million by the Programme Office at Monaragala for the use of 27 Rubber Processing Centres had remained idle for over a year.
- (c) The vehicle procured on 05 July 2011 at a cost of Rs. 4.60 million had met with an accident on 19 November 2011 and subsequently condemned and remained at the premises of Tea Small Holder Development Authority. According to the Project Director, the insurance claim made thereon was dishonored as the accident occurred due to a misconduct of the driver.