

Poverty Alleviation Micro Finance Project -II and Revolving Fund - 2017

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 2017 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 Democratic Socialist Republic of Sri Lanka then Japan Bank for International Co-operation, presently known as the Japan International Co-operation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Poverty Alleviation Micro finance Project-II, the Central Bank of Sri Lanka is the Executing and Implementing Agency of the Project. The objectives of the Project are to improve the income level of the people remain below the poverty line and enhance formal financial services for them by providing credit for income generating activities, improving management and training capacity of Participating Financial Institutions and Partner Agencies and increasing income generating opportunities and skills development of beneficiaries, thereby contributing to alleviating poverty, mitigating regional inequity and supporting peace building. As per the Loan Agreement, the estimated total cost of the Project amounted to Japan Yen 2,759 million equivalent to Rs.3,076 million and out of that Japan Yen 2,575 million equivalent to Rs. 2,704 million was agreed to be provided by the Japan International Co-operation Agency. The Project commenced its activities in January 2009 and scheduled to be completed by December 2013. Further, the effective date of the Loan for final disbursement purposes had been extended only up to 12 November 2015. However, the financial statements for the year ended 31 December 2017 had been prepared and presented for audit.

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 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.

1.4 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. 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 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

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 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 management and the reliability of books, records, etc. relating to the operations of the Project and the Revolving Fund.
- b) Whether the expenditure shown in the financial statements of the Project and the Revolving Fund had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project and the Revolving Fund.
- c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project and the Revolving Fund from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project and the Revolving Fund in financial and physical terms, the assets and liabilities arising from the operations of the Project and the Revolving Fund, the identifications of the purchases made out of the Loan etc
- d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- e) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project and the Revolving Fund.
- f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project and the Revolving Fund.
- g) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- 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.

2. Financial Statements

2.1 Opinion

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 Project had maintained proper accounting records for the year ended 31 December 2017 and the financial statements give a true and fair view of the state of affairs of the Project and the Revolving Fund as at 31 December 2017 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilised for the purposes for which they were provided.,
- (c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (d) the financial covenants laid down in the Loan Agreement had been complied with.

3. Financial and Physical Performance

3.1 Utilization of Funds

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 2017 are shown below.

Source	Amount agreed for financing according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	Funds Utilized			
	JPY million	Rs. million		During the year under review		As at 31 December 2017	
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	2,575	2,704.00	-	-	-	2,562	3,470.00
GOSL	-	372.00	47	-	40.50	-	292.90
	<u>2,575</u>	<u>3,076.00</u>	<u>47</u>	=	<u>40.50</u>	<u>2,562</u>	<u>3,762.90</u>

3.2 Physical Progress

According to the information collected, the Project had released 59,215 sub loans valued at Rs. 3,213 million at the end of the period of the Project through 11 Participating Financial Institutions and out of that 50,076 of sub loans representing 86 per cent of total value of sub loans had been released through 03 state owned Participating Financial Institutions whilst other 9,139 sub loans representing 14 per cent of the value of sub loans had only been granted by 08 Participating Financial Institutions in private sector.

Further, a Revolving Fund Account had been opened with the Central Bank of Sri Lanka in August 2011, as per the Section 4 (1) of Article III of the Loan Agreement and the operations of the Revolving Fund had been commenced in 2013. According to the information received, sub loans valued at Rs. 1,033 million had been released during the year under review by the Revolving Fund and the balances of sub loans aggregating Rs.6,680 million granted through 05 Participating Financial Institutions had remained outstanding as at 31 December 2017.

3.3 Identified Loss

It was observed that an impairment loss amounting to Rs.3.11 million had been recognized as at 31 December 2017 and a provision for Rs.37.7 million had been made in the financial statements of the year under review on the Reverse Repurchase Investment matured on 01 January 2018 due to breach of contractual agreement made with the Central Bank of Sri Lanka by the Primary Dealer engaged in the respective Reverse Repurchase Investment.