

Agriculture Sector Modernization Project - Part 01 - 2017

The audit of financial statements of the Agriculture Sector Modernization Project- Part 01 for the first accounting 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 Schedule 2, Section II, B,3 of Financing Agreement No. 5873-LK dated 17 January 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement of the Part -01 of the Project, then Ministry of Primary Industries, presently Ministry of Social Welfare and Primary Industries is the Executing and the Implementing Agencies of the Project. The objectives of the Project are to support to increase agriculture productivity, improve market access and enhance the value addition of smallholder farmers and agribusinesses in the Northern, North-Central, Central, and Uva Provinces. Further, the activities for support for the promotion of commercial and export-oriented agriculture to attract and leverage investments from farmer producer organization and agribusinesses for high value agriculture production and value addition and to provide environment, incentives and access to finance for such investments including (a) investment preparation support; (b) Matching Grants to producer organizations and agribusinesses and (c) Partial Credit Guarantees. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 105.61 million equivalent to Rs.15,413.78 million and out of that US\$ 61.37 million equivalent to Rs.8,956.95 million was agreed to be provided by the International Development Association. In addition, US\$ 44.10 million equivalent to Rs. 6,436.40 million expected to be contributed by the beneficiaries of the Project. The Project commenced its activities on 15 October 2016 and scheduled to be completed by 31 October 2021.

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 and for such internal control as the management determines as necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 Auditors 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 judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessment, 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 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 controls 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 the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) 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 operation of the Project, the identification of the purchases made out of the Loan, etc
- (d) Whether the initial deposits 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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Financing Agreement.
- (f) Whether the funds, material and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles, and
- (i) Whether financial covenants laid down in the Financing 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 as at 31 December 2017 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the initial deposit, withdrawals from and the 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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) the Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Financing Agreement, and
- (e) the financial covenants laid down in the Financing Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Non- Compliance with Laws, Rules and Regulation

The following observations are made.

- (a) A Project Steering Committee had not been established for the purpose of the smooth operations of the activities of Project, as required by Section 09 of the Circular No. 01/2016 of 24 March 2016 of the Department of Management Services.
- (b) The Project had procured a web bases GIS software procured at a cost of Rs.4.25 million by the Project during the year under review had not been recorded in the Register of Computer and Accessories in terms Circular No. IAI/2002/02 of 28 November 2002 of the Ministry of Finance.

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 up to 31 December 2017 are shown below.

Sources	Amount agreed for financing in the Financing Agreement		Allocation made in the Budget Estimate for the year under review		Funds utilized as at 31 December 2017	
	US\$ million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
IDA	61.37	9,213.01	4.66	700	2.19	335.00
Beneficiaries						
Contribution	44.10	6,620.39	-	-	-	-
GOSL	0.14	21.00	0.33	50	-	-
Total	<u>105.61</u>	<u>15,854.40</u>	<u>4.99</u>	<u>750</u>	<u>2.19</u>	<u>335.00</u>

According to the Annual Budget Estimate, a sum of Rs.750 million had been allocated for activities of the Project for the year under review. However, only a sum of Rs.335 million representing 44.67 per cent of the total allocation had been utilized during the year under review.

3.2 Physical Progress

The activities of the Project consist with 03 sub component such as investment preparation support, matching grants to farmer producer organizations and supporting a partial credit guarantee to share the financial risk with Participating Financial Institutions that one interested in lending to the beneficiaries under the matching grants programme. The following observations are made on the progress of implementation of the activities of the Project.

- (a) The comprehensive detailed Action Plan to be prepared in order to achieve the objectives of the Project within the scheduled period by using the allocated resources had not been prepared.
- (b) The allocation of US\$ 7.12 million allocated to carry out activities under the Project Credit Guarantee Component had not been utilized up to 31 December 2017 even after elapse of one year from the date of commencement of the Project.
- (c) The Project had selected 04 private entities engaged in agri businesses to award matching grants and cheques valued at Rs.46.91 million were written on 31 December 2017 in favour of those entities and recorded as expenditure of the Project.

However, respective cheques had not been handed over to entities even up to 31 May 2018.

- (d) The matching grant program is expected to support approximately 350 farmer producer organizations in 07 priority districts of Jaffna, Mullative, Anuradhapura, Batticaloo, Monaragala, Matale and Polonnawaruwa which are characterized by high poverty headcounts. However, the Project had selected Galle and Colombo District to implement the Matching Grant programme.

3.3 Matters in Contentious Nature

A sum of Rs.11.85 million had been spent by the Project to meet the cost on air travel, subsistence and other cost for the delegation of 20 persons headed by Minister-in-Charge visited Israel without obtaining approval from the relevant authorities.

3.4 Extraneous Expenses

Eventhough the Project had procured 02 motor vehicles at the cost of Rs.15.7 million during the year under review, those vehicles had been transferred to the Ministry of Social Welfare and Primary Industries without utilizing for the activities of the Project. However, the Project had taken over a used motor vehicle from the Line Ministry and spent a sum of Rs.0.51 million to repair the vehicle.

3.4.1 Human Resources Management

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According to the paragraph 3.2 of the Circular No 1/2016 of 24 March 2016 of the Department of the Management Services, remuneration of the staff of the Project should be determined based on the foreign contribution of the Project. However, the remuneration of the staff of the Project had been determined under the category of Project which exceeds the foreign contribution of US\$100 million eventhough the foreign contribution of this Project was remained at US\$ 67.37 million. As a result, remuneration of the staff of the Project had been determined erroneously and a sum of Rs.3.28 million had been overpaid during the year under review.