

Financial Sector Modernization Project - 2023

The audit of financial statements of the Financial Sector Modernization Project for the year ended 31 December 2023 comprising the statement of financial position as at 31 December 2023 and the statement of expenditure and cash flow statement for the year then ended and notes to the financial statements, including material accounting policy information 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 provisions in the Financing Agreement No. 6006 dated 04 October 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. My comments and observations which I consider should be reported to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement, the Ministry of Finance is the Executing Agency and the Central Bank of Sri Lanka, Security Exchange Commission and Insurance Regulatory Commission of Sri Lanka are the Implementing Agencies of the Project. The objectives of the Project are to contribute to increasing financial market efficiency and use of financial services among micro, small and medium enterprises and individuals. The activities of the project are implemented under 03 components namely results based financing, investment based financing and project implementation and monitoring and front end fee. As per the Financing Agreement, the estimated total cost of the Project was US\$ 75 million equivalent to Rs.22,500 million and this amount was agreed to be financed by IDA. The Project had commenced its activities on 18 October 2018 and scheduled to be completed by 31 December 2022. However, the date of completion of the activities of the Project had been extended up to 30 June 2023 and activities of the project was closed on 29 December 2023.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2023, statement of expenditure and its cash flow for the year then ended in accordance with Sri Lanka Accounting Standards.

1.4 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.5 Responsibilities of management and those charged with governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

1.6 Auditor's Responsibilities for the audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit.

I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Physical Performance
2.1 Financial Progress of the Activities

Audit Issue	Response of the Management	Auditor's Recommendation
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The following observations are made.

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| (i) Out of total allocation of Rs.339 million had been made in the budget estimate for the activities of the project for the year under review, a sum of Rs.73 million representing 22% percent had not been utilized by the project. | Agree with the observation. | Action should be taken to utilize the total allocated funds as intended |
| (ii) Total estimated cost of the project is USD 75 million. Although, the project had been completed in six years lapsed since the inception, the total loan utilization of was only USD 8.95 million which is 11.94% of the estimated cost of the project. | Agree with the observation. | -Do- |
| (iii) The project is liable to pay 0.25% commitment charges on unutilized loan. Accordingly uneconomic commitment charges of Rs.221,135,313 (USD 992,133) had been paid to funding agency from 2018 to 2023. | Cannot made any comments since commitment charges are handled by ERD. | -Do- |
| (iv) There was no any activity carried out by the project in the year 2023. The overall physical progress of the project as at 31 December 2023 is given below. | Agree with the observation. | Necessary actions should be taken to achieve targets as intended. |

	No. of Activities	Physical Progress
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Component 01

DLI 1 - Adoption of consolidated, risk based supervision of the financial system (CBSL, SEC & IRCSL)	3 activities	6.5%
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DLI 2 - Establish Institutional and Regulatory Framework for Financial Consumer Protection (FCP), Enabling Result: Implementation of legal and regulatory framework for FCP and development of institutional capacity for FCP across all financial services	1 activity	6.5%
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DLI 3 - Establish an information system for holistic management of Employee's Provident Fund (EPF's) assets (investments) and liabilities (collections) and adopt a diversified investment strategy.

1 activity 0.00%

DLI 4 - Establishment of Delivery vs Payment (DvP) mode of settlement for corporate securities to minimize possible risks to financial stability.

3 activities 6.5%

DLI 5 - Restructuring of the National Insurance Trust Fund (NITF) by separating the underwriting and reinsurance businesses.

1 activity 6.5%

Component 02

(a) Strengthening the capacity of CBSL for supervision and regulation, and modernizing relevant financial infrastructure

2 activities 0.74%

(b) Strengthening the capacity of SEC for supervision and regulation, and modernizing relevant financial infrastructure

9 activities 1.65%

12 activities 0.00%

(c) Strengthening the capacity of IRCSL for supervision and regulation, and modernizing relevant financial infrastructure

2 activities 1.69%