

Enhancing Small and Medium– Sized Enterprises Finance Project - Credit Line Component - 2024

The audit of financial statements of the Enhancing Small and Medium–Sized Enterprises Finance Project - Credit Line Component (the Project) for the year ended 31 December 2024 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 of Project Administration Manual under the project No: 50349-002 of Loan Agreement No. 4441- SRI(COL) dated 25 March 2024 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank. 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 Loan Agreement of the Project, the Ministry of Finance, Planning and Economic Development is the Executing Agency and the Department of Development Finance is the Implementing Agency of the Project. The objective of the project is to enhance Small and Medium–Sized Enterprises (SMEs) access to finance, to support their recovery from the economic crisis and helping to improve their adaptive capacity to deal with vulnerabilities stemming from changes in their business operating environment including from climate change. As per the Loan Agreement, the estimated total cost of the Project was US\$ 50 million equivalent to Rs.14,839.96 million which was agreed to be financed by Asian Development Bank. The Project had commenced its activities on 07 May 2024 and scheduled to be completed by 31 August 2030.

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 2024, financial performance and its cash flows 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 Responsibility of the 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 misstatements, 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 skepticism 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. Financial Performance

2.1 Financial Progress of the Activities of the Project

	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The Project designed to enhance access to finance and strengthen the economic capacity of SMEs, was allocated USD 50 million (LKR 14,839,960,000). As at 31	Agree with fund allocation amounts. Even though the financial disbursement progress of the 1st advance is lower than 59 percent with	The prompt actions should be taken to strengthen the monitoring processes to utilize funds

December 2024, the total allocation had been disbursed in two phases among 13 Participating Financial Institutions (PFIs). Under the first phase, a total of LKR 6,826,381,600 had been disbursed to all 13 PFIs. Based on the fund utilization progress, ten PFIs that had utilized more than 80% of their initial allocations were provided a second-phase disbursement totaling LKR 8,013,578,400 on 11 November 2024. However, as at 31 December 2024, three PFIs had utilized less than 59% of their first-phase allocations, out of these one PFIs had not utilized any portion of the funds received.

respect to three (03) PFIs, effectively. those banks have disbursed the loans for the end-borrowers and only the submission of documents was in progress.

- (b) In accordance with the sub-loan agreements with PFIs under the loan agreement No. 4441– SRI(COL), eight PFIs had utilized over 86% of the loan funds disbursed after 12 months of the funds allocated date while two institutions had utilization levels below 60%. As per the Project’s operational guidelines, any unutilized funds remaining after one year from the date of disbursement should be reallocated by the Steering Committee to PFIs that have demonstrated satisfactory utilization. However, as at 21st May 2025, the Project management had not taken the necessary steps to reallocate the unutilized funds of Rs.632,089,600

At the Steering Committee meeting held on 14th May 2025, the decision had been taken to allow the PFIs to fully utilize the funds of first advance by 15th June, 2025. Those loans applications are being received to Department of Development Finance for final approval.

Prompt actions should be taken to reallocate unutilized or underutilized funds and to strengthen the monitoring and evaluation processes.

- (c) Furthermore, as at 21 May 2025, a total of 1,273 SME sub-loans had been granted through the 13 PFIs under the project. Although the Project aims to strengthen monitoring by conducting field inspections to assess loan utilization and project impact, it was observed

These field visits are funded by ADB grant and that grant was received in the 4th quarter of the year 2024. More field visits have been scheduled during coming months of this year.

Actions should be taken to strengthen the monitoring framework for sub-loan utilization and to assess the progress and impact of project implementation.

that only 18 field inspections had been carried out as at the audit date of 24 June 2025. This indicates inadequate monitoring of the loan utilization and the progress of the project implementation.

3. Physical Performance

3.1 Loan Administration

Since the Project is executed through qualified participating financial institutions (PFIs - Banks), the Banks are required to ensure proper administration of loans granted under this Project in order to achieve the intended objectives of the loan scheme and to safeguard the Bank's interests by minimizing the risk of credit defaults. However, during the sample audit verification carried out in three government banks namely, Bank of Ceylon, People's Bank and Rural Development Bank, the following deficiencies were observed.

	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	As per the Manager's Circular/Limit Paper, environment Protection License had not been obtained or renewed for seven loans, amounting to Rs.60,000,000.	The relevant Branches were instructed to obtain License.	Take necessary actions to adhere with the circular instructions.
(b)	As per the Manager's Circular/Limit Paper, the bank should conduct regular follow-ups to ensure the proper utilization of each installment. However, contrary to the above circular, the branches have not taken follow up steps accordingly for ten loans, amounting to Rs.77,000,000.	Relevant Instructions have been given to the Regional Credit Units to follow up the conditions.	Take necessary actions to adhere with the circular instructions.
(c)	As per the Manager's Circular, a project follow-up report should be prepared and submitted to the Small & Medium Enterprises Development Unit within 30 days, one year after the final disbursement of a loan. However, any evidence was not available regarding the submission of project follow-up report to the Small	Relevant Instructions have been given to the Regional Credit Units to follow up the conditions.	Take necessary actions to adhere with the circular instructions.

& Medium Enterprises Development unit for two loans, amounting to Rs.11,000,000.

- | | | | |
|-----|---|---|--|
| (d) | As per the provisions of Manager's Circular No. 877/2024 of a particular PFI, the borrowers are required to insure their respective stock. However, no evidence was available regarding the insurance of stock for four loans amounting to Rs.34,500,000. | Relevant instructions have been issued to the Branch Manager. | Take necessary actions to adhere with the conditions of loan approval. |
| (e) | As per the loan conditions, the borrowers were required to maintain adequate income through their respective current accounts. However, for ten loans amounting of Rs.96,500,000, the sufficient income or cash flow of the business had not been deposited into the respective accounts. | Informed the customers to deposit the sufficient income and Cash flow of the business is routed through relevant account. | Need to closely follow up the agreed revenue flow to the bank. |
| (f) | As per the loan conditions, all borrowers should be obtained sufficient insurance coverage for the building and machineries of the business. However, the aforesaid insurance policy was not available in the correspondence loan files relating to the two loans valued at Rs.19,000,000 | Noted the comments. The Branch Manager had been instructed. | Take necessary actions to ensure the compliance with loan conditions. |