

Agriculture Sector Modernization Project -Part 01 -2020

The audit of financial statements of the Agriculture Sector Modernization Project -Part 01 for the year ended 31 December 2020 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 the Financing Agreement No. 5873-LK dated 17 January 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 Financing Agreement, of the Part -01 of the then Ministry of Primary Industries, presently Ministry of Plantation is the Executing and 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, Eastern, North-Central, Central, and Uva Provinces. The activities of the Project are implemented under 03 components namely Investment preparation support, Matching grants to farmer producer organizations and agribusinesses and Partial credit guarantee. As per the Financing Agreement, the estimated total cost of the Project was US\$ 106.97 million equivalents to Rs. 15,612 million and out of that US\$ 63 million equivalents to Rs. 9,176 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44 million equivalents to Rs. 6,436 million is expected to be financed by the beneficiaries. The Project had commenced its activities under the retroactive financing on 15 October 2016 and scheduled to be completed by 31 October 2021.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 02 of my report, the accompanying financial statements give a true and fair view of the financial position Project as at 31 December 2020, statement of expenditure and its cash flows for the year then ended in accordance with the Generally Accepted Accounting Principles.

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 this 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 for the Financial Statement

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

1.6 Scope of Audit

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. Comments on Financial Statements

2.1 Accounting Deficiencies

The following observations are made.

No	Accounting Deficiencies	Management Responses	Auditor's Recommendations
(a)	Contribution made by the beneficiaries to implement the activities of the Project had not been separately identified and recorded in the financial statements.	Presently there is no mechanism to account the beneficiary contribution.	Project should identify the contribution of the beneficiaries and the amount of contribution should be disclosed separately in the financial statements.
(b)	Even though the balance of Matching Grant Control account and Matching Grant creditors account should be equal, the difference of Rs. 3,962,166 was observed between those accounts in the financial statements.	We agree with the difference and it will be reconciled in the Current year -2021	Action should be taken to identify the difference and rectify the error.

3. Physical Performance

3.1 Physical and Financial Progress of the Activities of the Project

The activities of the Project are implemented under 3 components namely.

- (a) Investment preparation support
- (b) Awarding of matching grants to farmers producer's organizations and agribusiness
- (c) Partial credit guarantee

No	Component	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	Awarding Matching Grants	(i) The Matching Grant Program was initially identify to assist approximately 350 Farmer Producer Organizations in seven priority districts with high levels of poverty, after which 15 more districts, including Colombo, were added to the project. Out of these newly added districts, Gampaha, Kalutara and Kurunegala districts were allocated 74 percent from the total allocation	Project took all possible steps to make investors aware on the grant scheme in these identified districts by organizing large scale awareness programs. Due to the low response from poverty stricken districts, PMU had to consider investment proposals from other districts which had more feasible projects with high investments.	Action should be taken to monitor the Project activities in order to achieve the objectives of the Project.

		(ii)	Even though the Project had approved a sum of Rs. 1,184.07 million as matching grants to 65 proponent companies up to 31 December 2020, the matching grants had not been released even after lapse of period 6 to 30 months from the dates of approval.	The delay is mainly due to the following reasons; Not ready to start the project, legal documents are not submitted on time, due to Covid, delay in obtaining approvals at the time of implementing projects and delays of submitting proposals.	-Do-
		(iii)	Although the second grant amounting to Rs 144 million had not been released up to 31 December 2020 from the approved grants of Rs. 341 million, it has been 5 to 15 months since the first installment was issued due to incomplete work.	The delay is mainly due to the proponent not being able to expedite the project work which is case sensitive to the nature of project and travel restrictions levied across the globe.	-Do-
		(iv)	Approved grants amounting to Rs.4,830 million had been given in 2017, 2018 and 2019 for 232 investors over a period of two to three years but only 4 investors amounting to Rs. 57.83 million had been completed their investment by the end of the year 2020.	The both parties work towards eliminating undue delays and expediting the Tranches within the stipulated parameters.	Action should be taken to monitor the Project activities in order to achieve the objectives of the Project.
(b)	Partial Credit Guarantee		Allocation amount of US\$ 7.12 million had been done to carry out the activities under the component of Partial Credit Guarantee of the Project had not been utilized up to 31 December 2020.	The auditor's view on Partial Credit Guarantee is factual and accepted.	Action should be taken to get the support to implement this loan scheme through Private Bank.

3.2 Contract Administration

Audit Issue	Response of the Managements	Auditor's Recommendation
The Project entered in to an agreement with a consultancy firm to get the assistant to prepare business proposals for micro and small projects. Due to non-achievement of expected outcome, the contract work had been terminated after paying Rs. 1.97 million.	The payments were made as per agreement and for the satisfied performance and services delivered and payment is justified.	Need to adhere with objective of the project and take necessary action to minimize the operational cost of the project.

3.3 Underutilized Resources

Audit Issues	Response of the Management	Auditor's Recommendation
It was observed that only a sum of US\$ 13.09 million equivalent to Rs. 2,135.42 million representing 21.54 per cent of the total allocation of US\$ 60.77 million equivalent to Rs. 8,869.38 million made by the Lending Agency had been utilized as at 31 December 2020 after lapse of 04 years from the commencement of activities of the Project.	The utilization is 33% and not 21.54%	Action should be taken to monitor the Project objectives in order to achieve the objectives of the Project.

3.4 Extraneous Activities

The following observations are made.

No.	Audit Issues	Responses of the Management	Auditor's Recommendations
(a)	A sum of Rs. 213,000 had been spent on printing applications which were not relevant to the objectives of the project and they were at the stores idle.	These application forms were printed to be used for Farmer Outreach programme which was going to be done with the collaboration of Samurdhi development which was under the same Ministry of Social Welfare and Primary Industries.	Action should be taken to monitor the Project objectives in order to achieve the objectives of the Project.
(b)	The Project had incurred a sum of Rs. 270,000 as repair cost on a vehicle which was not belongs to the Project.	This vehicle repair was carried out in 2018 on the vehicle which was allocated to the Project Director by the then line Ministry as there was no vehicles available at the project at the beginning.	Action should be taken to monitor the Project objectives in order to achieve the objectives of the Project.