

Agriculture Sector Modernization Project – Part 01 - 2022

The audit of financial statements of Agriculture Sector Modernization Project – Part 01 for the year ended 31 December 2022 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 the Financing Agreement, the Ministry of Plantation Industries is the Executing and Implementing Agency 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 equivalent to Rs. 15,612.28 million and out of that US\$ 62.87 million equivalent to Rs. 9,175.88 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44.10 million equivalent to Rs. 6,436.40 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. Subsequently, period of the project had been extended up to 31 December 2024.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the 2.1 section of my report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2022, statement of expenditure and its cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

1.4 Basis for Qualified 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 Generally Accepted Accounting Principles 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. Comments on Financial Statements

2.1. Accounting Deficiencies

	Accounting Deficiencies	Amount Rs. Million	Responses of the Management	Auditor's Recommendation
(a)	Estimated beneficiary contribution had been shown erroneously under the liabilities without showing under the equity.	16,556	The corresponding credit entry was shown as Beneficiary Contribution and Grant utilization, which can be shown as Equity from the financial year 2023.	Financial statements should be presented in accordance with Sri Lankan accounting standards.
(b)	The credit balance of the World Bank/IDA of US\$ 39.8 million as at 31 December 2022 had not been translated in to LKR value of the reporting date and as a result the loan balance and project expenditure balance shown in the statement of financial position had been understated.	6,830	This adjustment was not done in the past years and highlighted during this audit. Accordingly, we will make arrangement to do the adjustment in financial year 2023.	Accounts should be kept as per Sri Lanka Accounting Standards.

2.2. Non Compliance with Laws, Rules and Regulations

	Reference to the Laws, Rules and Regulations	Audit Issue	Responses of the Management	Auditor's Recommendation
(a)	Circular No 01/2022 dated 07 February 2022 issued by the Department of Management Audit.	Internal Audit Committee meeting should be held once per quarter. However, none of meeting had been held during the year under review.	The Project has been carried out under the supervision of several ministries from time to time and participation has been maintained in all the audit committee meetings held by those ministries. Currently, a separate Audit Committee Meeting is conducted specifically for the Project.	Need to adapt with instructions given in the circular.
(b)	In accordance with the Payment of Gratuity Act No. 12 of 1983 and Sri Lanka Accounting Standards 19.	The provision had not been made for the gratuity due upon leaving the service of the project staff.	Rectify in 2023 Accounts	Accounts should be kept as per Sri Lanka Accounting Standards.

03. Physical Performance

3.1 Physical and Financial Progress of the Activities of the Project

Component	Audit Issue	Responses of the Management	Auditor's Recommendations
(a) Matching grants.	(i) It was observed that targets which were set in the Project Appraisal Document issued by International Development Association related to following project objectives were not able to be achieved. as at 30 April 2023, four objectives which had achieved less than 55 percentage were unable to achieve within project period of 5 years and it is uncertain to the audit whether those objectives would be able to achieve in next one and half year.	The progress of four PDOs mentioned has been determined based only on the number of completed sub-projects as at 30.04.2023. The number of completed sub-projects by 30.04.2023 was 630. There are 758 remaining on-going sub projects to be reviewed 55 percent of the total number of sub-projects to count the above indicators (PDOs) for the completion of the set targets. Those 4 PDO indicators are lagging behind due to start-up delays and challenges associated with COVID -19 pandemic and recent economic crisis, but a gradual improvement has been noted from the 2 nd quarter 2023 onwards. As such, when 758 sub-projects are completed, the progress of achieving targets in another 20 months can possibly reach the final targets of PDOs.	The project should work towards achieving the desired objectives.
	(ii) Due to the weakness of monitoring activities of the project, the second tranche of Rs.1,023 million which was to be given to 263 investors who were given the first tranche of the matching grant given by the project to the investors was delayed from the commencement of the project to 31 December 2022. Furthermore, the payment of Rs.389 million to be paid as the third tranche to 249 investors who were given the first tranche and the second tranche was delayed from the commencement of the project to 31 December 2022.	This is mainly due to various problems faced by investors. Releasing of the 2 nd tranche will vary based on the work in progress in the 1 st tranche of the project and further releasing of funds will not happen until the matching percentages (grant and own contribution) are met.	The project should work to achieve the desired objectives within the relevant period.

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| <p>(iii)The project started in the year of 2017 and the project was supposed to be completed by December 2022. However the duration of the project was extended till 30 June 2024. According to the time taken for the payment of matching grant, by June 2024, it was observed that it will not be possible to pay Rs.3,727 million as matching grant for 1,405 projects which have not been started.</p> | <p>The remaining Matching Grant to be paid as at April 30,2023 is Rs.Mn.3,015, instead of Rs.Mn. 3,727 as mentioned in audit report. The total number of sub projects to date is only 1388. As of 30 June 2023, PMU has already disbursed Rs.Mn. 236.3 of matching grant. As such total remaining matching grant to be disbursed is Rs. Mn. 2779, Of this amount Rs.Mn. 620.7 has been allocated for 12 large window projects, which is under discussion with the line ministry to commence implementation. PMU has made a plan to disburse remaining matching grant amount of Rs. Mn.2158.3 by 30th June 2024, i.e six-months prior to the date of project extension 31 December 2024.</p> | <p>The project should work to achieve the desired objectives within the relevant period.</p> |
| <p>(iv) Matching Grant amount of Rs.4 million had been given to a Mill on 19 May 2021 and 02 March 2022 under EOI/2020/03/771, the production was not commenced by 31 December 2022.</p> | <p>Commercial operation of Kalana Fiber Mill (Pvt) Ltd. was started on 23/01/2023 and it has been observed that the production process is being carried out successfully.</p> | <p>Funds should be utilized efficiently.</p> |
| <p>(v)A sum of Rs. 85.72 million of the matching grants had been released in year 2017, 2018 and 2019 to some companies that were abandoned their project activities. Although those grants shall be refunded, only Rs. 49.48 million was refunded as at the end of the year under review. The balance amount of Rs. 36.25 million has to be recovered at the end of the year under review.</p> | <p>The balance amount of Rs.36.997 million to be recovered from 4 proponents and action has been taken.</p> | <p>Funds should be utilized efficiently.</p> |

(b) Cluster Projects	(i) Director Board Paper No. 2019/021/1/02-04 had approved the implementation of 41 cluster projects, only the cluster project bearing FPG/CO/2022/2/24 had been implemented.	The Board Paper No 2019/021/1/02/-04 presented to the Board by the PMU was based on the recommendation of Coconut Cultivation Board (CCB) and Coconut Development Authority (CDA) under the Ministry of Plantation Industry. Although 41 cluster projects have been approved under the 'Kapruka Societies' subsequently it was decided to pilot only one cluster Group recommended by the CCB/CDA, which is FPG/CO/2020/2/24	The project should work to achieve the objectives efficiently and effectively.
	(ii) Even though an approval has been obtained for the procurement of rope grinding machines worth Rs.700,000 for the 50 members of the Palanthriyagoda Ekamuthu Kapruka Society through the cluster project of FPG/CO/2020/2/24 under Board of Directors Paper No.2019/021/1/02-04, an amount of Rs.2 million was credited to 202 people exceeded the groups approved at Rs.120,000 each on 25 November 2020. The progress on the cluster of entrepreneurs created in relation to rope products had not been inspected and reported by the Southern Provincial Matching Grants Manager.	The query referred to the allocating matching grant of Rs.700,000 for 50 members, which are not belong to Palanthriyagoda Eakamuthu Kapruka Society and it should be 202 members with the matching grant of Rs.2,828,000. This amount has been disbursed to the society to procure semi-automatic yarn making machines. At the time of submitting the Board Paper, it was decided to supervise the implementation of this cluster project by CCB/CDA and the Kapruka Society itself. Considering the amount of work load of the Southern Regional Matching Grant unit, the Grant Manager coordinated the whole project with the supervision role of CCB/CDA.	Work should be under the supervision of concerned responsible officers.

- (c) **Partial credit guarantee** It was observed that the allocation amounting to US\$ 7.12 million had been made to carry out activities under the component of Partial Credit Guarantee and it had not been utilized up to 31 December 2022. According to the explanations made by the Project several awareness programs with the representatives of Licensed Commercial Banks had been held and the action had not been initiated by the respective Banks, due to problems faced in administrative arrangements.
- The allocation amounting to US\$ 7.12 million to carry out activities under the component of Partial Credit Guarantee of the Project is totally controlled and monitored by the Regional Development Department of the Central Bank of Sri Lanka. Commercial Banks are reluctant to utilize this scheme due to administrative issues. Hence, the amount allocated was revised and out of the total allocation, US\$6.12 million was transferred to Matching Grant Scheme leaving a sum of US\$ 1.00 million.
- The project should work towards achieving the objectives.

3.2 Unutilized Resources

Audit Issue	Responses of the Management	Auditor's Recommendations										
(a) Even though the two modules of Desktop Spatial Analyst Extension and Desktop 3D Analyst Extension belonging to the GIS software purchased by the project in the year of 2017 at an additional cost of Rs.867,000 the usefulness of those modules were not identified and are in idle without usage.	In 2017,ASMP decided to procure the GIS software (ArcGIS desktop advanced license 10.5.1) package instead of going it for the full package which was more suitable for the purpose with the two extensions (Desktop spatial analysis and Desktop 3D analysis)The above two extensions are used at the final phase of the project. It is required to use these two extended packages to perform detail analysis. If we planned to purchase two extensions at the latter part of the project, we have to upgrade the ArcGIS platform to a newer version to suit to add the extensions that would be more expensive than the initial cost.	The project should be aligned with the objective and the data system should be used up-to-date.										
(b) It was observed that only a sum of US\$ 39.84 million equivalent to Rs. 7,634.37 million representing 65 per cent of the total allocation Of US\$ 61.19 million equivalent to Rs. 8,869.38 million made by the Lending Agency had been utilized as at 31 December 2022 after lapse of 05 years from the commencement of activities of the Project.	<p>Details of the allocated Grant amount and the expenses incurred are given below,</p> <table border="1" data-bbox="592 1554 1219 1794"> <thead> <tr> <th></th> <th>US\$ Mn</th> </tr> </thead> <tbody> <tr> <td>Total amount of Grant allocated</td> <td>61.19</td> </tr> <tr> <td>Expenditure as at 31/12/2022</td> <td>39.84</td> </tr> <tr> <td>Cancellation of allocation by MOF</td> <td>10.00</td> </tr> <tr> <td>Balance available as at 31/12/2022</td> <td>11.35</td> </tr> </tbody> </table> <p>As the project period has been extended till 31/12/2024, the remaining balance of US\$ 11.35 can be utilized within the balance period.</p>		US\$ Mn	Total amount of Grant allocated	61.19	Expenditure as at 31/12/2022	39.84	Cancellation of allocation by MOF	10.00	Balance available as at 31/12/2022	11.35	The activities of project should be properly planned to increase the efficiency of fund utilization.
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