

The audit of financial statements of the Agriculture Sector Modernization Project – Part 02 Project for the year ended 31 December 2023 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 Agriculture 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 value addition of smallholder farmers and agribusinesses in Jaffana, Mullaithivu, Anuradhapura, Batticaloa, Matale, Monaragala, and Polonnaruwa districts. Further, the activities for the support for smallholder farmers to produce competitive and marketable commodities, improve their abilities to respond to market requirements and move towards commercialization are expected to be carried out under the Agriculture Sector Modernization Project – Part 02. The activities of the Project are implemented under four components namely Farmer Training and Capacity Building, Modern Agriculture Technology Demonstration Parks(ATDP), Production and Market Infrastructure Development and Analytical and Policy Advisory Support.

As per the Financing Agreement, the estimated total cost of the Project was US\$ 86.865 million equivalent to Rs. 26,059.5 million and out of that US\$ 61.295 million equivalent to Rs. 18,388.5 million was agreed to be financed by the International Development Association. In addition, US\$ 25 million equivalent to Rs. 7,494 million had been received from the European Commission Trust Fund to implement the activities in other districts such as Kandy, Badulla, Ampara, Kilinochchi and Vavunia. The balance amount of US\$ 0.6 million equivalent to Rs 177 million is expected to be financed by the Government of Sri Lanka.

The Project had commenced its activities on 01 January 2017 and scheduled to be completed by 31 December 2021. However, the date of completion of the activities 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 2023, statement of expenditure and its cash flows for the year then ended in accordance with 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 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

No	Accounting Deficiency / Audit Issue	Amount Rs. million	Response of the Management	Auditor's Recommendations
(a)	The credit balance of the World Bank/IDA of US\$ 49.7 million and the balance of EU Grant of US\$ 12.44 million as at 31 December 2023 shall be translated in to LKR value by using central bank exchange rate of Rs.323.92. But exchange rate of Rs. 330.54 had been used for the conversion. As a result, exchange difference shown in financial statement had been overstated by Rs.262.65 million.	262.65	The US\$ value of the Loan/Grant was converted to LKR using the exchange rate as of 31 December 2024, and the same procedure was adopted in the previous year as well. However, the observation of the Auditor General was well taken for the preparation of the Financial Statements for the year 2024.	Exchange difference should be calculated accurately by using correct exchange rate.
(b)	Even though a sum of Rs. 99.13 million to be incurred from Euro funds, it had been spent from World Bank funds by Eastern and Northern provincial offices since the beginning of the project up to the end of the year 2023.	99.13	Admitted. This was rectified during the year 2024.	Payments should be made as finance agreement process.

- | | | | |
|---|---------------|--|---|
| <p>(c) The balance of Rs.592.40 million and Rs.46.72 million had been shown in the financial statement as at 31 December 2023 as Cash at bank for World Bank funds and Euro Grant Funds respectively, but the related bank statement balances were Rs.695.93 million and Rs.84.28 million respectively as at end of the year 2023. Therefore, a difference of Rs.141.09 million had been observed between the balances of cash book and bank statements. Due to bank reconciliation had not been prepared by the project the difference had not been verified during the audit.</p> | <p>141.09</p> | <p>Admitted. The delay in the preparation of Bank reconciliation statements was mainly due to the absence of financial Management staff.</p> | <p>Bank reconciliation should be prepared timely to identify the differences.</p> |
|---|---------------|--|---|

2.2 Non Compliance with Laws, Rules and Regulations

No	Reference to the Laws Rules and Regulations	Non Compliance/Audit Issue	Response of the Management	Auditor's Recommendations
(a)	Circular No 01/2019 dated 15 March 2019 issued by the Department of Management Services.	Project Steering Committee (PSC) meeting should be held once in two month. However, only four PSC meetings had been held during the year under review.	Every effort was taken to conduct those meeting once in two months.	Project Steering Committee should be held as per the circular instruction.

3. Physical Performance

3.1 Physical progress of the activities of the Project

Audit Issue	Response of the Management	Auditor's Recommendation
The project commenced on 17 January 2017 and scheduled to be completed 80 per cent target as at 31 December 2023 but it was reported only 75 per cent overall physical progress as at 31 December 2023.	The external factors which took place during the project period such as Covid Epidemic, the Economic hanged and crisis direct impact on the financial and physical progress of the project.	Actions should be taken to expedite the project progress as scheduled.

3.2 Contract Administration

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The contract was awarded to private company on 07 February 2022 for the construction of 18 cultivation wells on estimation amount of Rs.44,585,198 for the Ambul banana project in Rajanganaya area of Anuradhapura district. According to the contract, the construction of the wells was to be completed by 07 April 2022. As at 08 April 2024, the construction of 7 wells had not been completed and the construction of 2 wells had not been used. The extension had not been given after 06 January 2023 for the construction of cultivation wells.	Out of 18 Agro Wells, 16 Agro Wells have been completed by the contractor and however, the construction of 2 Agro Wells as the walls of those wells were collapsed.	Activities of the project should be completed as planned.
(b)	Due to weaknesses of procurement files related to the construction of the Central Provincial Deputy Project Office, the information of the contractors, recoveries from advance bonds for commencement of work on the contract, the date of commencement of the contract, the date of completion of the project, the retention, the payment etc. could not be correctly identified.	Admitted. This has now been rectified. However, the service contract of the officer responsible for the lapses was not extended.	Documents should be maintained as proper manner.
(c)	Even though the qualifications of the bidders were specifically requested on Construction Industry Development Authority (CIDA) at grade C-6 or higher was mandatory for the construction of the Gonawewa Market Access Road, the contract was awarded to a C-7 grade bidder for Rs.11.10 Mn. Further, Rs.2.2 Mn was paid as an advance for the commencement of work on 13 September 2023 and the work had not commenced until 28 October 2024.	Admitted. The contract was terminated and furthermore, the service contract of the Provincial Engineer who was responsible for this issues was not extended.	Actions should be taken to select suitable contractor for the contractors for the construction works.

- | | | | |
|-----|---|--|--|
| (d) | The Central Province Deputy Project Office had awarded the contract for the construction of 14 tube wells in the Wewellawa Tank area on 24 April 2023 at an estimated cost of Rs.14 Mn. Although the construction work was to be completed on 24 September 2023, the construction had not been completed by December 2023 and work on 2 tube wells had not been commenced. | The Construction of 14 Tube Wells have now been completed and the farmers are using the facility for their Cultivations. | Construction should be completed within the pre-determined time frame. |
| (e) | A contract was awarded to a private company on 17 June 2019 for the construction of an anicut for the use of 34 farmers in the Passion Fruit Cultivation Project in the Waguruwela area of Buttala, Uva Province, at an estimated cost of Rs. 34 Mn. By the end of 2023, the construction of the anicut had not been completed. The passion cultivation project had failed due to non-fulfillment of desired objectives of the project. | The Construction of the Anicut in Waguruwela has been completed in 2024 and benefited by the farmers. | Desired objectives should be achieved as scheduled. |

3.3 Observations made on site visits

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	In the Hasalaka area of the Kandy district, 400 aluminum ladders, polythene covers for banana cans and banana planting bags had been purchased without prior study of farmers. The purchased equipment had been stored in a house rented at Rs. 360,000 annually in the Hasalaka area and an agreement had been entered with a private company for the security of the warehouse of paying of Rs. 936,000 per year. It was observed that the expenditure of Rs. 1,296,000 incurred for one year was uneconomical.	Those inputs are not delivered to the beneficiary farmers until their plots are ready for cultivation. As such it is necessary to store them in a safe custody.	The activities should be properly planned and funds should be used effectively and efficiently.

3.4 Idle/ Unutilized/ Underutilized Resources

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The project Agreement was signed on 17 January 2017 and to be completed by 31 December 2021. However the World Bank/IDA had approved to extend the project period till 31 December 2024. When considering the progress of utilization of funds as at 31 December 2023, it was observed that the project utilized only USD 44.677 Mn funds from allocated funds of the IDA Loan of USD 61.295 Mn. As a percentage, it was 72.8 percent. Therefore, it was observed the utilization of funds was ineffective when considering the rest of one year period with balance funds.	It is admitted that the Project had initially to completed by 31st December 2021 and due to the factors beyond the control of the Project, the completion period was extended until 31st December 2024.	Funds should be utilized effectively and efficiently.
(b)	According the grant agreement No.TFOB5383 was signed 17 May 2021 between the Secretary to the Treasury and the European Commission. The European Commission has agreed to provide a grant of USD 24.95 Mn, the cumulative use of European Commission grant as at the end of year under review was only USD 10.507 Mn. and it was equivalent to 42.12 percent of the agreed amount. Therefore, remaining 57.88 percent of EU grant fund utilization in next year is uncertain.	It is admitted that the Project had initially to completed by 31st December 2021 and due to the factors beyond the control of the Project, the completion period was extended until 31st December 2024.	The activities should be properly planned and funds should be used effectively and efficiently.
(c)	It was observed that the year under review, the project has utilized only Rs.3,742 Mn from allocation for the reimbursable foreign loan of Rs.4,765 Mn. Therefore, allocation of Rs.1,023 Mn representing 21 percent of the total allocation had not been utilized by the project.	Admitted, though we planned to utilize the Budgetary allocation fully. It was not possible due to the delay in receiving of Goods In time.	Funds should be used effectively and efficiently.
(d)	Budgeted contribution of European Commission grant for the year under review was Rs. 3,000 Mn, the Project had utilized of EU grant only Rs.1,476 Mn and it is equivalent to 49 percent of agreed amount. Therefore, 51 percent has not been utilized for the Project during the year.	Admitted, though we planned to utilize the Budgetary allocation fully. It was not possible due to the delay in receiving of Goods In time.	Properly planned and funds should be used effectively and efficiently.

- | | | | |
|-----|---|---|--|
| (e) | It was observed that Non-refundable tender deposit amount of Rs.6,847,500 which was collected for 433 procurements during the 2023 by the project have not been transferred to the ministry as at 24 December 2024. Therefore, the credit balance was indicated in the financial statement. Furthermore, it was observed that amount of Rs. 6,847,500 has been idle in the bank account more than one year. | The Non-refundable Tender Deposits were refunded to the Ministry of Agriculture, Livestock, Lands and Irrigation . | Non-refundable deposit should be transferred timely. |
| (f) | According to the information received to the audit, distribution of fertilizer for farmers for the years of 2022 and 2023 was implemented as per the request from World Bank. 25 percentage of contribution shall be collected from the farmers under this project. The collected 25 percent contribution amount of Rs.67 Mn has not been transferred to the Treasury as at 24 December 2024. This amount was represented in the financial statement under Other Payable item. Furthermore, it was observed that amount of Rs.67 Mn has been idle in the bank account more than one year. | Admitted. Action is being taken to transfer the beneficiary contributions to the Consolidated Fund. | Funds should be transferred timely and should be complied with the instructions. |
| (g) | 380 rolls of polythene mulch worth Rs. 32,224,000 purchased by the project for distribution to farmers belonging to the Uva Provincial Deputy Project Office had been stored idle for more than 18 months in a warehouse owned by the Department of Agriculture in Pelwehera. | As the Cultivation of MD-2 Pineapple had to be suspended, the entire quantity of Polythene Mulch procured were delivered among the farmers. | Funds should be used effectively and efficiently. |

3.5 Matters in Contentious Nature

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	It was observed that the imprest amount of Rs.1,000,000 due from Uva Provincial Project Management Unit has not been settled as at 31 December 2023. This amount was represented as other advance under current asset in the financial statement as at 31 December 2023.	Admitted, this has been rectified.	The imprest should be settled immediately.

(b) Cluster potato project in Jaffna District

- | | | |
|--|--|--|
| (i) When purchasing 20 MT of seed potatoes worth Rs. 13,010,250 for distribution to farmers included in the proposed cluster potato project to be implemented in the Jaffna area, the details of the manufacturer, weight of the potato tuber, date of manufacture and expiry date could not be identified due to the absence of a bar code. | Although there were no Barcodes available in sacks of Seed Potatoes, the information related with the Manufacture, weight, date of manufacturing, dare of expiration ect. Had been included in the labels of potato sacks. | Manufacturing details should be disclosed. |
| (ii) The preliminary laboratory investigation report of the National Plant Quarantine Service of the Department of Agriculture stated that a fungus called Geotrichum was found in potato seeds imported for the Potato Cluster Project in the Jaffna area. Therefore, it was mentioned that more consideration should be taken when storing potato seeds. However, due to the storage of seeds in a poorly ventilated area, packed in sacks and stored together, the Geotrichum fungus had spread and destroyed the potato seeds. | Comments have not been made by the Management. | Instruction given by the experts should be followed and fund should be utilized efficiently and effectively. |
| (iii) Although the seed potatoes imported for the potato cluster project in the Jaffna area were supposed to be between 28 mm-55 mm in size, the size of the seeds tested ranged from 70 mm-80 mm. 830 seed potatoes packed in 25kg bags were not individually weighed. | According to the Specifications approved for this procurement, the size of a seed should have been the range of 28-55MM. It was confirmed by the technical team of the Project that 95 percentage of the quantity was within the approved range. | Seeds potatoes should be complied with the specifications. |
| (iv) Rs. 14,487,900 was spent on the purchase, storage, disposal and other expenses of seed potatoes (Red la Soda) for the potato cluster project in the Jaffna area of Agriculture Sector Modernization Project, which is being implemented with the loan obtained by the Government of Sri Lanka on a loan and interest repayment basis from the World Bank Fund. It is observed that this expenditure was a useless expenditure and that the objectives of obtaining the potato seed harvest have not been achieved. | Comments have not been made by the Management. | The activities should be properly planned and implemented for achieving desired objectives. |

- | | | |
|---|--|--|
| <p>(v) Audit query No. ARI/D/ASMP/Part 02/A/2023/AQ/12 and dated 31 March 2024 had been issued regarding the destruction of 20 MT of Red la Soda seed potatoes imported in November 2023 for the Potato Cluster Project in Jaffna Province. The response to the said audit query from the Secretary to the Ministry of Agriculture and Plantation Industries (letter No. ASRI/5/32/MIN/AR/236 dated 10 July 2024) to the Auditor General, stated that it had been agreed to supply the required quantity of seeds for the coming season at the supplier's expense in place of the destroyed seeds. But potato seeds were not supplied until November 2024.</p> | <p>As agreed, the supplier had supplied the required quantity yet that consignment was failed at the quarantine tests.</p> | <p>Action should be taken to recover the losses.</p> |
| <p>(c) After the failure of the MD-2 pineapple cultivation project in Laggala area of Matale district, instead of pineapple cultivation, a project of T.J.C. Mango cultivation to cultivate 100 acres with the contribution of 200 farmers had been started in June 2023 at an estimate of Rs.125 million. As at the end of 2023, only 100 beneficiaries had been selected.</p> | <p>The Department of Agriculture and Review Panel had a different views on the proposal. As such we had no option but to shift for an alternative crop.</p> | <p>The activities should be properly planned and implemented for achieving desired objectives.</p> |
| <p>(d) With the aim of modernizing mango cultivation as an export crop for the international market, mango cultivation had been commenced on 81 hectares with the participation of 204 farmers in the Dambulla area on 16 February 2021. Although the mango cultivation project was scheduled to be completed by June 2022, the project had procured mango plants for distribution to farmers on 16 March 2023. Accordingly, the mango cultivation project had not been completed within the proposed time frame. Although an estimated cost of Rs. 3,360,000 was estimated for the construction of an elephant fence to protect mango plantations from wild elephants, the elephant fence had not been constructed. According to the project proposal, although it was planned to be spent Rs. 36,480,000 on improving the road network,</p> | <p>It is admitted that the establishment of the Mango Cluster Dambulla could not be completed within the expected time frame due to factors beyond the control. Anyhow, the planting of mango has been completed by June 2024.</p> | <p>The activities should be properly planned and implemented for achieving desired objectives.</p> |

Rs. 3,191,440 for the construction of a drainage canal, Rs. 8,383,186 for the construction of a compost yard, Rs. 1,920,000 for drone inspection and mapping and Rs.4,975,000 for the acquisition of machinery for the compost yard, those activities totally valued at Rs.54,949,626 had not been completed. Accordingly, the mango cultivation project had not been achieved the desired goals.

(e) Due to the inability to find a plain land in the hilly areas like in the North Central Province where chillies are widely cultivated, the chillies had been destroyed by rainwater and floods due to the Helmalu method and having to find half an acre of land in several places. And also, the use of pumps and the drip system were disabled. Although a chilli drying machine was installed in Kurunduwatta area, the use of the drying machine had also failed due to the fact that the farmers carrying chillies had to travel a distance of 13-40 km from the farm to reach the drying machine.	The programme was not success due to whether conditions as well as the attitudes of the Beneficiary farmers. The equipments so delivered to farmers were took back.	Feasibility study should be done before implementing the project activities.
(f) When physical inspection, it was observed that farming equipment purchased for distribution to farmers, there was a surplus of 213 Galvanized (GI) pipes, a shortage of 177 rolls of Insect Proof, a shortage of 139 water pumps, a shortage of 07 Foot Valve and a shortage of 12,105 Nursery rays and a shortage of 2.8 kg of chilli seeds. As receives and issues of beads and spirals were not recorded. Therefore, it was not possible to identified deficiencies and excesses.	Necessary action will be taken on the findings of the Internal Auditor.	F.R.751 should be followed in relation to project inventories and stock.
(g) Out of the 20 cultivated lands that were physically checked, except for one plots, the farmers in the remaining 19 cultivated lands had not used the goods provided by the project. Those 19 cultivated lands had failed due to floods, rain or cold weather.	Action has already been initiated to take back the un used inputs delivered to the beneficiary farmers.	The activities of the project should be planned and implemented for achieving the desired goals.
(h) The hybrid maize seed production project was started in Kandaketiya area of Badulla district with an estimated cost of Rs. 90 Mn which was implemented on the aid of the European Union. 50 farmers and 50 acres of paddy land owned by farmers were taken over for this project. The project had failed completely due to non-selection of farmers as per the project criteria, non-selection of right cultivation land, non-identification of suitable seeds for cultivation land, non-delivery of seeds, fertilizers and agro-chemicals within due time. The amount of Rs.2.67 Mn incurred had been an idle expenditure.	The crop was changed to chill and 14 farmers had left from the project. 36 farmers are engaging with cultivation.	Funds should be used effectively and efficiently to achieve desired goals.
(i) Although Rs.28.4 Mn was spent on the moringa project consisting of the estimated cost of Rs.32 Mn and 100 beneficiaries, the cultivation of moringa was not	The Indian variety was highly attacked by the pests. Accordingly the	The activities of the project should be planned and

successful due to the use of foreign seed sources instead of local sources as moringa seeds. Accordingly, the expenditure of Rs.28.4 Mn incurred had become useless. farmers have moved into local variety. Of the 100 farmers nearly 50 percent are successfully cultivating and others are also have initiated the cultivation. implemented for achieving the desired goals.

- (j) In the procurement of 23 electronic scales valued Rs 23 Mn a formal estimate and specifications were not prepared and quotations were not called as per Section 2.14 of the procurement guidelines. Furthermore, failure to enter into an agreement on bid securities and warranty period and by paying Rs. 247,667 more than the price of the local agent due to non-quotation from the local agencies has been incurred a loss by the Government. Comments have not been made by the Management. Government procurement procedures should be followed.

3.6 System and Controls

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Monitoring Information System (MIS) worth of Rs.7,084,550 was used by the project in May 2021 which was after four years and five months from the beginning of the project. According to best practice , all system and information of a project should be handed over to the Ministry at the end of the project period. As per information received to audit, the project has not formal plan on handing over system and information to ministry as at 12 September 2024, although the project will be completed on 31 December 2024.	It has already been planned to hand over the Monitoring Information System (MIS) together with the relevant Source Codes and Operational Manuals to the National Agriculture Information and Communication Centre (NIACC) of the Department of Agriculture before the expiration of the Grace Period.	Action should be taken to handing over project assets to Line ministry at the project end.