

Strengthening Climate Resilience of Subsistence Farmers and Agricultural Plantation Communities residing in the vulnerable river basins, watershed areas and downstream of the Knuckles Mountain Range Catchment of Sri Lanka Project - 2023

The audit of financial statements of the of Strengthening Climate Resilience of Subsistence Farmers and Agricultural Plantation Communities residing in the vulnerable river basins, watershed areas and downstream of the Knuckles Mountain Range Catchment of Sri Lanka 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 provisions in the sub Section 17.01(b) of the Accreditation Master Agreement dated 10 January 2022 entered in to between the Green Climate Fund and International Union for Conservation of Nature and Natural Resources (IUCN) and provisions in the Sub Section 5.16 Implementing Agreement dated 19 August 2022 entered in to between the Ministry of Irrigation and International Union for Conservation of Nature and Natural Resources (IUCN). 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 Grant Agreement of the Project, the Ministry of Irrigation and International Council for Research in Agroforestry (ICRAF) are the Executing and implementing Agencies of the Project. The objective of the Project to strengthen the climate resilience of subsistence farmers and agricultural plantation communities in vulnerable river basins, watershed areas, and downstream regions of the Knuckles Mountain Range Catchment by improving farm and land management practices, enhancing water security, and safeguarding ecosystems to mitigate climate-related risks. The activities of the Project are implemented under four components namely Climate-Resilient Sustainable Land Management, Secure Financing Mechanisms for Sustainable Land Management, Institutional capacity strengthened and Project management. As per the Grant Agreement, the estimated total cost of the Project was US\$ 48.98 million equivalent to Rs15,672. million and out of that US\$ 39.78 million equivalent to Rs. 12,729 million was agreed to be financed by Green Climate Fund (GCF). The balance amount of Rs. 9.2 million is expected to be financed by the Government of Sri Lanka. The Project had commenced its activities on 23 August 2023 and scheduled to be completed by 16 January 2029.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.1 of this report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2023 and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

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 Sri Lanka Public Sector Accounting Standards, and for such internal control as management determines as 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. Audit Observations on Preparation of Financial Statements

2.1 Accounting Deficiencies

	Accounting Deficiency/ Audit Issue	Amount Rs. million	Management Response	Auditor's Recommendation
(a)	Even though a contractual right to receive cash can be identified as a financial asset in accordance with Section 11 C of the Sri Lanka Accounting Standards (LKAS) 32, however, the funds received and retained in the Treasury, amounting to Rs. 905 million had not been recognized as a receivable balance under current assets and the Equity.	905	When using the cash basis of accounting, revenues and expenses are recognized only when cash is received or paid. Hence, we cannot show receivable cash from treasury as a cash receivable.	Funds retained in the Treasury should be disclosed in the financial statements
(b)	Even though, Rs.11 million had been accounted as payable to the project under trade and other payable in the financial statements prepared by the Mahaweli Consultancy Bureau for the year ending 31st December 2023, it had not been accounted as receivables in the financial statements prepared for the project in the year under review.	11	The advance given to the Mahaweli Consultancy Bureau from the Knuckles Project has already been reported as an expenditure for the year 2023; hence, we cannot recognize this amount as a receivable	Receivables should be accounted in the financial statements.
(c)	According to the financial statements of the Mahaweli Consultancy Bureau, the income receivable from the project was Rs. 2	2	When using the cash basis of accounting, revenues and expenses are recognized only when cash is received or paid. Once the Mahaweli Consultancy Bureau submits	Payable balances should be accounted in the financial statements

million. However, there was no any payable balance due to the company in the financial statements of the project.

its expenditure report to the project, we can classify the expenditure as project component expenses.

3. Non Compliance with Laws, Rules and Regulations

Reference to the Laws Rules and Regulations	Audit Issue	Management Response	Auditor's Recommendation
Financial Regulation of the Democratic Socialist Republic of Sri Lanka F.R. 371(b)	According to Financial Regulation 371 (b), pertaining to the provision of ad-hoc advances, a maximum amount of Rs. 100,000 can be granted as an ad-hoc advance in a single instance exclusively to officers in an organizational capacity for specific tasks. However, contrary to this regulation, the project has granted Rs 5,179,540 advances in eighteenth instances to 13 officers engaged on a short-term contractual basis under work assignment arrangements by the Project Officers and the Mahaweli Consultancy Bureau (Private) Limited, without the approval of the Department of State Accounts	Comments had not been received.	Action should be taken to comply with the Financial Regulation

4. Physical Performance

4.1 Physical and Financial Progress of the Activities of the Project

	Audit issue	Management Response	Auditor's Recommendation
(a)	The main agreement related to this project, with the Green Climate Fund (GCF), which provides project funding, and the accredited entity IUCN, was signed on 13 March 2020. However, according to the project document prepared for the initiative, project activities were planned to commence on 17 January	Comments had not been received	Project activities should be commenced within the intended timeline

2023, and completed on 16 January 2029. Nevertheless, the project activities actually began on 10 August 2023.

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| (b) | According to the project document, activities amounting to US\$ 5,186,805 were planned for the first year. However, by 31 December 2023, expenditures under components 01, 02, and 4 amounted to only US\$ 82,694 (LKR 26,462,082). Proportionally, this represents 1.5% of the planned expenditure. | Comments had not been received | Project fund should be utilized effectively for the intended purpose. |
| (c) | As per the project document, project activities were to commence on 17 January 2023, and the inception report and baseline report were to be released within three months, by April 2023. However, as of 31 December, 2024, these reports remained in draft form and had not been approved by the Green Climate Fund. | Comments had not been received | Project activities should be done as planned in the project documents. |

5. Human Resource Management

	Audit Issue	Management Response	Auditor's Recommendation
(a)	According to the Funded Activity Agreement (FAA) signed on 13 March 2020 between the Green Climate Fund and the International Union for Conservation of Nature (IUCN) for the project, the Project Director was to be selected through a formal and competitive process conducted by a committee established by the National Steering Committee. However, the Ministry of Irrigation had not followed this procedure. Furthermore, the agreement stipulated that an individual should be permanently appointed to this position but the Ministry of Irrigation had appointed an Additional Secretary of the Ministry as the Project Director on a temporary basis	Comments had not been received	Adhere to the Funded Activity Agreement.

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| (b) | <p>Additionally, an engineer from the Ministry of Irrigation had appointed as Deputy Project Director, but a role had not been specified in the Funded Activity Agreement (FAA). Further information had not been provided for the appointment. Moreover he was simultaneously serving as the Project Director of the "Wew Gam Pubuduwa" project and the Chief Executive Officer of the Mahaweli Consultancy Bureau. and also he was participated for the National Steering Committee as amember without a formal appointment. Therefore his effectively contribution to the project activities was questionable in audit.</p> | Comments had not been received | Adhere to the Funded Activity Agreement |
| (c) | <p>In relation to the recruitment of officers for the project, the salaries paid to project employees were contrary to both the terms of the Funded Activity Agreement (FAA) and the provisions of the Department of Management Services Circular 01/2019, specifically Section 3.1(c). Furthermore, the Deputy Project Director, who also serves as the Chief Executive Officer of the Mahaweli Consultancy Bureau (Private) Company, facilitate for the temporary recruitment of 39 individuals as employees and consultants through this company under various salary scales. A total of Rs 52 million was paid as salaries for these temporary recruits during the year 2023/2024</p> | Comments had not been received | Adhere to the Funded Activity Agreement. |

6 Matters in Contentious Nature

Audit Issue	Management Response	Auditors recommendation
For the activities of the project, the necessary motor vehicles were procured on a rental basis directly by the project and through external organizations via the Mahaweli Consultancy Bureau (Private) Company. A total amount of Rs. 35,008,999 was paid as vehicle rental by the project during the years 2023/2024. Furthermore steps had not been taken to	Comments had not been received	Action should be taken to obtain Treasure approval.

obtain the necessary Treasury approval by specifying the following details: the types of vehicles required for the project, the method of acquiring them, the expenses that could be borne using project funds, and the parties responsible for providing the vehicles.