

Environmentally Friendly Solutions Fund Project II (E-Friends II) - 2010

1. Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to the paragraph 03 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2010 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2010 in accordance with Generally Accepted Accounting Principles,
- (b) the withdrawals from and replenishments to the Special Yen Account during the year ended 31 December 2010 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2010 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (c) the statements of expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement,
- (d) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (e) the financial covenants laid down in the Loan Agreement had been complied with.

3.2 Unreconciled Difference

According to the financial statements presented, the balance of the E-Friends Revolving Fund Account II as at 31 December 2010 was Rs. 1,923,418,341 and the corresponding balance shown in the statement of Central Bank of Sri Lanka was Rs. 1,908,910,183 thus showing an unreconciled difference of Rs. 14,508,158.

3.3 Lack of Evidence for Audit

Following observations are made.

- (a) The information relating to issue of Eligibility Clearance and approval granted for sub-loans by the Project Management Unit (PMU) during the year under review were not made available to audit.
- (b) Appropriate documentation and files with regard to loan applications received for sub-projects, project proposals with appraisal reports, loan approval forms, quarterly progress reports, etc. had not been maintained by the PMU.

3.4 Non-compliance with Operating Instructions and Minutes of Discussion

Following observations are made.

- (a) According to the Minutes of Discussion (MOD) on E-Friends II Project between the Japan Bank for International Cooperation (JBIC) and the Government of Sri Lanka (GOSL) on 03 December 2003, the JBIC mission and the officials of GOSL had confirmed the implementation schedule and measures to be adopted for the implementation of the Project. However, according to the information made available, it was observed that, the PMU and other concerned agencies had failed to comply with the following decisions.
 - (i) Conducting annual impact study on benefit accrued as a result of the Project activities.
 - (ii) Conducting appropriate public relation campaigns to let the public and end-users know about the Project.
 - (iii) Taking all necessary measures to implement the Project smoothly and effectively. E.g. many deficiencies relating to recruitment and deployment of staff including key posts of the PMU were observed in audit.

(i) According to the comments received from the Secretary to the then Ministry of Enterprise Development and Investment Promotion, all the functions of the vacant post of Project Director had been covered by him and accordingly, some corrective actions in order to streamline the loan approval procedure had been taken by the Secretary, by introducing appropriate documents. However, it was observed that no such procedure had been implemented properly. Details are given below.

¾ A sum of Rs. 804.19 million (JPY 637.16 million) had been disbursed to Participating Credit Institutions (PCI) during the year under review with regard to 76 sub-projects under this loan scheme. However, out of 76 sub-loan files, 34 numbers of loan files with regard to the sub-loans amounting to Rs. 235,093,714 were not made available for audit. According to the loan files submitted to audit, it was observed that proper approval had not been obtained for such loans.

¾ Loan approval forms, which were used to approve loans by the Secretary to the then Ministry of Enterprise Development and Investment Promotion, relating to a sum of Rs. 804.19 million under 76 sub-projects, were not made available to audit. Nevertheless, out of 06 numbers of loan approval forms relating to 13 sub-projects submitted to audit, only a sum of Rs. 17.75 million for 05 sub-projects had been approved by the Secretary to the Ministry concerned, but that amount too had not been disbursed to PCIs by the PMU during the year under review.

(b) Disbursements Procedure

According to the financial statements and information made available, district wise loans distribution made during the year under review is given below.

District	Disbursements	
	Amount	As a percentage
	Rs.	%
Kalutara	24,055,211	2.99
Badulla	32,950,000	4.10
Kandy	95,803,205	11.91
Colombo	338,858,707	42.14
Gampaha	112,737,900	14.02
Matale	4,125,000	0.51
Polonnaruwa	11,800,000	1.47

- (c) Before transferring the Project to the Ministry of Industry and Commerce, two Accounts Assistants had been appointed for the PMU of the then Ministry on two different monthly salary scales of Rs. 35,000 and Rs. 16,500 without obtaining the approval from the General Treasury. Although, the post of Accounts Assistant was not categorized under managerial level in the Management Services Circular No. 33 of 05 April 2007, a monthly salary of Rs. 35,000 had been paid to an Accounts Assistant up to August 2009, which was in contrary to the provisions of the above Circular. In addition, after the retirement of one of those employees at the end of the contract period, another person had been recruited for that post indicating that the post was vacant which was not within the cadre, and without obtaining approval from the Department of Management Services. Further, according to Section 2:2:5 (d) of the Management Services Circular No. 33, the interview board should have been chaired by the Project Director with the representatives from the Implementing Agency. However, a person had been recruited for the above mentioned post without calling for applications and even not conducting interviews. Further, according to the information made available to audit, the minimum qualifications required for that post, had not possessed by the person who was recruited for that post.

4 **Unsettled Issues**

Following Observations are made.

- (a) As per the Operating Instructions of the Project, the PMU should issue the Eligibility Clearance for an E-Friends II sub-loan within one month of the receipt of the completed application documents at the PMU and on receipt of the Project Clearance, the Participating Credit Institutions (PCI's) could proceed with the appraisal of the Project. Accordingly, the PMU was required to issue the Eligibility Clearance before approval and disbursement of E-Friends II sub-loans. However, according to the information made available to audit, following instances of non-compliance with the above operating instructions were observed.
- (i) Out of the total disbursements of Rs. 1,671,071,404 made for the year 2009, a sum of Rs.1,104,205,499 or 66 per cent had been disbursed by the Project without issuing the eligibility clearance.
- (ii) A sum of Rs. 188,081,250, relating to 10 sub-projects, had been approved for disbursement before issuing the eligibility clearance.

- (iv) According to the audit inspection carried out in July 2010, it was observed that, those machines were not in operations and only a few numbers of workers (03 to 05) were engaged in some manual productions. The reasons revealed at the discussion that had with the management of the company, for idling of such machines, were as follows.
- ¾ Non-availability of chemicals for operations.
 - ¾ Lack of working capital (It was revealed that approximately a sum of Rs. 15 million was required to commence operations).
 - ¾ Certain parts of the control panel of such machines were missing and those parts had to be imported.
- (v) Even though, the objective of the Project is to improve the environment and meet the environmental safety standards, an environmental impact study or a feasibility study on the said sub-project had not been carried out by the PMU.
- (vi) The following matters also revealed at the discussion that had with the Manager, Bank of Ceylon, Moratuwa branch.
- ¾ The company had not settled amounts payable as interest and installments of the existing loan to the Bank.
 - ¾ One machine out of the machines purchased from the E-Friends-II loan and mortgaged against the loan to the bank had been disposed off by the company without the approval of the bank.
- (vii) Field visit carried out by the audit on 24 September 2009 based on the report of the Environment officer of the Project, revealed that those machines had been installed some years ago and some productions had been tested but, those machines had not been used for a long time.
- (viii) Accordingly, it was observed that, the environmental improvement and the capability of that sub-project to meet the environmental safety standards had not been considered by the PMU when making disbursements to that sub-project.

