

**Pro-Poor Economic Advancement and Community Enhancement (PEACE)
Project (Component A)- 2012**

01. 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 in paragraph 3 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2012 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2012 in accordance with Generally Accepted Accounting Principles,
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the withdrawals from and replenishments to the Imprest Fund Account during the year ended 31 December 2012 had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2012 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) 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,
- (e) satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

02. Financial Statements

2.1 Financial Performance

According to the financial statements and information made available, the expenditure of the Project during the year under review amounted to Rs.584,292,445 and the cumulative expenditure as at 31 December 2012 amounted to Rs. 6,292,407,976. A summary of the expenditure for the year under review, expenditure for the preceding year and the cumulative expenditure as at 31 December 2012 are given in the following statement.

	Expenditure for the year ended		Cumulative
	31 December		expenditure as at
			31 December
			2012
	-----		-----
	2012	2011	
	Rs.	Rs.	Rs.
Fixed Assets	18,800,000	11,711,893	304,560,053
Vehicles	-	-	209,637,939
Work-in-Progress	220,374,486	447,525,295	1,073,692,155
Training and Capacity Building			
	18,295,560	55,030,916	430,466,566
Consultancy Services	10,605,290	246,561,048	980,833,544
Civil Works, Surveying and			
Constructions	316,217,109	869,784,649	3,293,217,719
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Total	584,292,445	1,630,613,801	6,292,407,976
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2.2 Imprest Fund Account

According to the financial statements and information made available, the operations of the Imprest Fund Account during the year under review, and the balance available as at 31 December 2012 are summarized below.

	Year ended 31 December 2012	
	JPY.	Rs.
Balance as at 01 January 2012	34,531,015	50,653,546
Add :-		
Replenishments	216,148,328	334,329,769
Foreign Exchange Gain	-	7,108,634
	-----	-----
	250,679,343	392,091,949
Less :		
Withdrawals	235,519,897	369,657,485
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Balance as at 31 December 2012	15,159,446	22,434,464
	=====	=====

03. Audit Observations

3.1 Accounting Policies

Following observations are made.

- (a) Although the accrual basis accounting policy had been followed in the preparation of financial statements, consultancy fees of Rs.17,578,441 relating to the previous year had been accounted as expenditure of the year under review.

- (b) Interest and service charges amounting to Rs.131,091,608 of the forth quarter of 2011 had been included to current year expenditure whilst expenditure of forth quarter of 2012 had been omitted from the accounts contrary to accrual principle. Further it was observed that sufficient information had not been obtained from the General Treasury to verify the accuracy of the interest and service charges relating to year under review.

3.2 Accounting Deficiencies

The following accounting deficiencies were observed.

- (a) Previous year closing balance of Rs.28,727,037 of the Exchange Rate Difference account had been brought forward to 01 January 2012 as Rs.23,999,621.No explanation had been given for the difference of Rs. 4,727,416
- (b) An unidentified difference of Rs.19,304 in sub Imprest account of the year under review and unidentified balance of Rs. 4,676 which was in preceding year balance sheet had been credited to imprest fund-CF account without reconciling with relevant accounts.
- (c) Even though according to the Balance Sheet, the fixed assets purchased during the year under review was Rs. 18,855,203 it had been shown as Rs.1,855,203 in the cash flow statement. Hence a difference of Rs.17,000,000 was observed.
- (d) Fixed assets such as rubber carpet, doors, windows and roofing sheets valued at Rs.234,650 had been erroneously classified and accounted as training expenditure.
- (e) Even though according to the Treasury Final printout, the total project expenditure during the year was Rs.631,084,310, it had been shown as Rs.584,292,445 in the Financial Statements indicating a difference of Rs.46,791,865.
- (f) A difference of Rs.21,730,281 was observed between the non - current assets in the balance sheet and statement of investment cost.

3.3 Non-compliance with Laws, Rules, Regulations and Management Decisions

Cash balances aggregating Rs. 634,136 of the Project as at end of the year under review had been retained with the Project in contrary to Paragraph 2.2.2. of the Treasury Operation Circular No. 05/2012 dated 20 November 2012.

3.4 Lack of Evidence for Audit

The following items in the accounts could not be satisfactorily vouched in audit due to lack of evidence indicated against each item.

Item -----	Value ----- Rs.	Evidence not made available -----
Sundry creditors.	1,603,821	Detailed schedules and age analysis
Sub Imprests	276,060,000	Receipt (General 172)
Casual labourers salary	589,444	Check rolls
	<hr/> 278,253,265 =====	

04. Financial and physical Performance

4.1 Utilization of Funds

Provisions amounting to Rs.696,577,719 had been made for the Project in the Annual Budget for the year 2012. According to the final Treasury Print-out, the total expenditure incurred during the year under review was Rs.631,084,310 and the total savings was Rs.65,493,409. As such fund amounting to Rs.65,493,409 had not been utilized for completing the project activities targeted for the year under review.

4.2 Financial Performance of Irrigation Works

The Department of Irrigation had undertaken to complete 09 major scale irrigation schemes, 09 medium scale irrigation schemes and 80 minor scale irrigation schemes under the Project. An annual work plan for the year under review had not been rendered to audit, up to 03 October 2013. Hence actual expenditure on civil works could not be compared with estimated expenditure. However, Rs.316,217,109 had been spent on civil works during the year under review. These civil works had been carried out without supervision of the consultant in Terms of Reference of the consultancy services agreement entered into between the Democratic Socialist Republic of Sri Lanka and Nippon Koei Company Ltd of Japan, in the year 2006, as the consultant had already left the Country in the year 2011. It was observed in the audit, that the consultancy period had not been extended up to end of the project period.

4.3 Physical Performance of Irrigation works

Physical progress report of the main and sub irrigation systems had not been rendered to audit, up to 03 October 2013. Hence it was impossible to evaluate the physical performance of the Project.

4.4 Credit Programme for Income Generation

The Ministry of Irrigation and Water Resources Management, Japan Bank for International Corporation (JBIC), Rajarata Development Bank and Wayamba Development Bank had entered into an agreement on 05 August 2008 to implement the Credit Programmes within the Project area. The main objective was to provide assistance to income generation activities of villagers and farmer organizations in the Project area. According to the Credit Programme agreement, a sum of Rs.82,000,000 had been allocated for this purpose. The loan disbursement and the progress of recovery as at 31 December 2012 is shown below.

Bank	Cumulative Number of borrowers as at 31.12.2012	Loan disbursements as at 31.12.2012	Loan recoveries as at 31.12.2012	Percentage of Recovery
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		Rs.	Rs.	
(a) Rajarata Development Bank	340	46,265,000	17,967,559	39
(b) Wayamba Development Bank	599	73,004,500	43,508,943	60
Total	939	119,269,500	61,476,502	52
	=====	=====	=====	=====

The following observations are made in this regard.

- (a)** The Rajarata Development Bank had granted loans to the value of Rs. 46,265,000 through its 7 branches of the area and Rs. 17,967,560 had been recovered out of the total loan value. Progress of the recovery was 39 per cent.
- (b)** The Wayamba Development Bank had granted loans to the value of Rs. 73,004,500 through its 6 branches of the area and Rs. 43,508,943 had been recovered out of the total loan value. Progress of the recovery was 60 per cent.

4.5 Financial Performance of the Consultancy Services.

The financial performance of the payments for consultancy services up to end of the year 2012 were as follows.

<u>Year</u>	<u>Foreign Aid</u>		<u>Reimbursable Foreign Aid</u>	
	<u>Provision</u>	<u>Actual</u>	<u>Provision</u>	<u>Actual</u>
	<u>made</u>	<u>Expenditure</u>	<u>made</u>	<u>Expenditure</u>
	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>
2006	66,600,000	21,284,388	44,100,000	8,102,502
2007	84,400,000	85,168,691	54,600,000	63,034,184
2008	85,400,000	28,547,962	54,600,000	54,022,245
2009	86,600,000	90,330,254	54,600,000	63,146,948
2010	17,600,000	133,320,435	10,500,000	176,709,597
2011	Not made available	98,571,858	Not made available	147,989,190
2012	Not made available	6,403,788	Not made available	11,174,653
Total	340,600,000	463,627,376	218,400,000	524,179,319

The following observations are made in this regard.

- (a) Even though Rs. 17,578,441 had been incurred as consultancy payments during the year under review provision for the year had not been made available.
- (b) Consultancy payments made for the year under review could not be satisfactorily examined due to non-availability of disbursement schedule of December 2012.

4.6 Unauthorized Payments

A sum of Rs.520,379 had been paid as hiring charges for running 17,735 kilometers under the consultancy payment without obtaining signatures of the officers, who were used the vehicles.

4.7 Extraneous Transactions

Construction of Poultry Layer Sheds for Niraviya farm

Payment of Rs. 8,513,972 had been made during the year under review for the Construction of several poultry layer sheds at a farm call "Niraviya" at Thabuththegama in Anuradhapura District.

Following observations are made with regard to this expenditure.

- (a) The farm called "Niraviya" was not an entity which had been legally established under the Project or under the Ministry of Irrigation and Water Resources Management.
- (b) Construction cost of Rs.3,128,013 out of the total expenditure had been erroneously classified and accounted as Training and Awareness Expenditure in the Financial Statements.

05. Systems and Controls

Special attention is needed in respect of the following areas of control.

- (a) Accounting
- (b) Monitoring of physical progress of irrigation schemes
- (c) Credit Programme
- (d) Progress report and payments of the consultants
- (e) Assets Management