

Small and Medium Enterprises Development Facility Project – 2012

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 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 Special (Dollar) 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 statement of expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Credit 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 Credit Agreement had been complied with.

2. Financial Statements

2.1 Financial Performance

According to the financial statements presented, the expenditure of the Project for the year ended 31 December 2012 amounted to Rs.1,551,325,620 and the cumulative expenditure as at 31 December 2012 amounted to Rs.2,415,808,941. The following statement shows a summary of the expenditure for the year under review, the expenditure for the year 2011 and the cumulative expenditure as at 31 December 2012.

Particulars	Expenditure for the year ended 31		Cumulative Expenditure as at 31 December 2012
	December 2012	2011	
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	Rs.	Rs.	Rs.
Fixed Assets	415,616	14,954,748	15,407,758
Funds of Participating Financial Institutions	1,521,446,408	818,461,340	2,339,907,748
Operating Expenses	11,929,939	22,094,564	39,166,294
Training and Development of Participating Financial Institutions	17,533,657	3,793,484	21,327,141
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	1,551,325,620	859,304,136	2,415,808,941
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2.2 Special (Dollar) Account

According to the books and records maintained by the Project and the information made available a summary of the operations of the Special (Dollar) Account maintained by the Central Bank of Sri Lanka for the year ended 31 December 2012 is given below.

	US\$ -----	Rs. ----
Balance as at 01 January 2012	22,219,700	2,530,852,743
Add -----		
Foreign Exchange Gain	--	308,578,840
	----- 22,219,700	----- 2,839,431,583
Less -----		
Withdrawals	(11,992,873)	(1,538,980,065)
	----- -----	----- -----
Balance as at 31 December 2012	10,226,827 =====	1,300,451,518 =====

3. Audit Observations

The following observations are made.

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

A suitable person should have been recruited as the Consultant to obtain services of high quality and standard. Nevertheless, the person who scored 87 marks at the interview had not been recruited. Despite recognising the person concerned as the person suitable for the Project in every respect, he had been rejected by adducing an incorrect interpretation that the gratuity requested could not be paid in terms of the Government Circulars and a person over the age of 60 years who had not been called for the interview had been recruited as the Consultant in terms of Paragraph 1.2 of the Guidelines on Selection and Employment of Consultants issued by the National Procurement Agency of Sri Lanka (August 2007).

3.2 Performance

The following observations are made.

(a) Payment of Loans

The particulars of the amount of loan approved for the Participating Financial Institutions and the amounts paid according to the Progress Reports furnished by the Project are given below.

Name of Participating Financial Institution	Amount Approved	Amount of Loans paid as at 31 December 2012	Amount of Loans paid as a percentage of Loans approved
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	Rs. Million	Rs. Million	%
Bank of Ceylon	492.75	336.66	68
People's Bank	314.44	247.37	79
Commercial Bank	479.56	322.57	67
DFCC Bank	365.90	353.20	97
National Development Bank	347.30	220.19	63
Regional Development Bank	261.85	168.69	64
Hatton National Bank	353.97	312.23	88
Sampath Bank	415.70	379.00	91
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	3,031.47	2,339.91	77
	=====	=====	

The following observations are made in this regard.

- (i) According to the above particulars, the progress of granting loans by the National Development Bank, Regional Development Bank, Commercial Bank and the Bank of Ceylon as compared with the other Banks had been at a low level and that represented 63 per cent, 64 per cent 67 per cent and 68 per cent respectively.
- (ii) The following weaknesses were observed in disbursing loans to and obtaining loans by the small and medium entrepreneurs.
 - i. The existence of delays in the Banks on refinancing work.
 - ii. An adequate guidance or training on the utilization of loans had not been provided to the Small and Medium Enterprises.
 - iii. Delays in obtaining loans by certain Small and Medium Enterprises and abandoning proposed project for obtaining loans.
 - iv. The cancellation of loans granted by Banks due to various reasons and the approval of loans for new enterprises in the last month of the year 2012.
 - v. Inability to release the loans and loans had been approved without identifying the business requirements through an evaluation of the project proposals submitted by the Small and Medium Enterprises.
- (iii) Even though the parties concerned had agreed to release the first tranche of all the loans approved within 06 months from the approval, loans amounting to Rs.26.5 million had not been released to two Small and Medium

Enterprises even after elapse of 10 months from the approval.

(b) Training

Conducting of training for providing technical assistance for strengthening the capacity of the officers of the Participating Financial Institutions and the Small and Medium Enterprises is one of the main objective of the Project and the particulars of training conducted up to 31 December 2012 are given below.

	Participating Financial Institution			Small and Medium Entrepreneurs		
	Number Participated	Cost per Officer	Total Expenditure	Number participated	Cost per Entrepreneur	Total Expenditure
		Rs.	Rs.		Rs.	Rs.
Development Finance Corporation of Ceylon Bank	563	4,848	2,729,189	1,167	1,450	1,692,520
Regional Development Bank	570	1,285	732,491	-	-	-
National Development Bank	583	11,216	6,538,812	788	754	594,375
Bank of Ceylon	2,015	1,064	2,145,690	1,430	1,601	2,289,640
Commercial Bank	152	1,373	208,711	644	388	250,077
Hatton National Bank	33	14,848	489,984	53	3,181	168,591
People's Bank	204	12,064	2,461,037	425	1,072	455,503
Sampath Bank	60	9,509	570,530	-	-	-

----- 4,180 =====	----- 15,876,444 =====	----- 4,507 =====	----- 5,450,706 =====
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The following observations are made in this regard

- (i) Even though a sum of Rs.787 million had been agreed to be made available by the World Bank for Capacity building of Participating Financial Institutions in relation to the provision of financing to Small and Medium Enterprises, and of such enterprises in relation to the effective utilization of such financing, the Participating Financial Institutions had agreed to obtain only a sum of Rs.427 million. Out of that, a sum of Rs.21 million only had been utilized by 31 December 2012 and that represented 5 per cent of the agreed amount.
- (ii) Even though the Sampath Bank had released the highest amount, that is, Rs.379 million out of the loans granted to the Small and Medium Enterprises in the year 2012, training programmes had not been conducted for the Small and Medium Entrepreneurs. Even though training had been conducted for the officers of the Bank and as compared with the other Banks, a lesser number of officers had been trained.
- (iii) Even though the Regional Development Bank had trained 570 of its officers, Small and no Small and Medium Entrepreneurs had been trained.
- (iv) Even though the Hatton National Bank and the People's Bank had trained 53 and 425 of their employees and Small and Medium Entrepreneurs respectively, as compared with the other Participating Financial Institutions, that had been at a lower level.
- (v) Out of the Participating Financial Institutions, the lowest cost for training of one Bank Officer had been incurred by the Bank of Ceylon and that amounted to Rs.1,064. The highest cost amounted to Rs.14,848 and that had been incurred by

the Hatton National Bank. The lowest cost for training of one Small and Medium Entrepreneur had been Rs.388 and that had been incurred by the Commercial Bank. The highest cost amounting to Rs.3,181 had been incurred by the Hatton National Bank. In view of the substantial variances in the cost incurred in the training for one officer it was observed that the training was lacking standards and planning.

(c) Distribution of Loans

(i) Even though the granting of loan facilities by identifying the Small and Medium Entrepreneurs in the Island is one of the objective of the Project, a large amount of loans had been released to Colombo, Gampaha and Kurunegala Districts. The value of loans granted to Ampara, Anuradhapura, Hambanthota, Jaffna, Killinochchi, Monaragala, NuwaraEliya, Trincomalee, Vavuniya, etc. taken as a percentage of the total loans granted, ranged between 0.02 per cent and 1.54 per cent. Therefore, the benefits had not been distributed proportionally among all the districts due to the non-operation of the Plan for creating awareness of this Loan Scheme for the Small and Medium Entrepreneurs properly and the grant of these loans only to the trustworthy long-standing customers.

(d) Creation of Risk Sharing Facilities

Signing of the agreements between the Sri Lanka Insurance Corporation and the Participating Financing Institutions and the Government of Sri Lanka for the minimisation of the possible losses resulting to the Commercial Banks from the loans granted to the Small and Medium Entrepreneurs should have been made together with the release of loans. Nevertheless, the risk sharing facility had not been created for the loans granted from the year 2011. As this agreement is remaining at the discussion level with the Attorney General, it was observed that it had not been possible to improve the trend in the granting of loans for Small and Medium Enterprises by the Commercial Banks through the Risk Sharing Facility which is a component of the Project.

(e) Progress of Utilisation of Small and Medium Enterprises Loans

The following matters with regard to the progress of the utilisation of the loans granted by the People's Bank and the Bank of Ceylon were observed at audit test check.

- (i) Achievement of profitability status of the Small and Medium Enterprises by the utilisation of the loans should be followed up by these Banks. Out of the 29 such loans granted it was observed that 08 of those loans had not been subjected to examination by the Banks. In this connection, it had not been established whether the socio-economic benefits had been expanded through the granting of loans.
- (ii) Instances of cancelling of the granting of loans due to the project proposals approved for obtaining the loans by the Small and Medium Entrepreneurs not within the planned project proposals were observed. If the relevant Banks had carried out proper evaluation of the project proposals submitted by the Small and Medium Entrepreneurs and creating an awareness in such instances it would not have arisen. Two such instances are given below.
 - A sum of Rs.5 million comprising Rs.4.3 million for the working capital of a chillies and curry powder grinding mill and a sum of Rs.0.7 million for investment in the industry had been approved. Later the loan recipient had made a loan application by changing the requirements as Rs.4.3 million for investment in the industry and a sum of Rs.0.7 million for working capital. As such a sum of Rs.0.7 million out of the amount approved only had been granted and the loan of Rs.4.3 million had been cancelled.
 - Even though a loan of Rs.15 million comprising a sum of Rs.2 million for working capital requirements and a sum of Rs.13 million for the purchase of machinery for a handloom factory had been approved, a sum of Rs.5 million comprising a sum of Rs.2 million for working capital requirements and a sum of Rs.3 million for the purchase of one machine had been released. Even though owner of the industry had requested the loan for the machinery purchased with his money, the granting of Rs.10 million for the machinery already purchased had been cancelled.

Even the machine installed on 20 January 2012 at a cost of Rs.3.5 million was not in working condition as at 19 March 2013.

- (iii) Increase of job opportunities in the process of expanding the economic activities of the small and medium enterprises also among the benefits expected to be achieved under this loan scheme. Nevertheless, 04 projects had not paid attention to increase the employees.
- (iv) Field inspection reports on the progress of the use of the loans granted by the Banks concerned for the intended purpose had not been reported the actual progress in 03 instances. There were another two instances in which it was stated that the machines were purchased before actually purchasing the machines while in another instance it was stated that the employees strength was 15 instead of actual employees of 10 .
- (v) Even though a loan of Rs.10 million comprising a sum of Rs.0.43 million for the purchase of machinery and a sum of Rs.9.5 million for working capital requirements had been granted for a furniture factory, it was not possible to confirm whether the approved loan for the working capital had been used for that purpose. Even the People's Bank Branch had not got that confirmation.
- (vi) A loan of Rs.10 million had been approved for a rubber grinding industry. Out of that a sum of Rs. 1.24 million had been released for the construction of a building complex on 13 January 2013 without releasing on stages. The construction work had not been started even by 18 March 2013. Even though a truck valued at Rs.1.36 million should have been purchased according to the loan approved it had not been purchased.
- (vii) The relevant Branch of the Bank of Ceylon had released a loan of Rs.3 million for the purchase of used machines for a garments factory without obtaining a valuation report from a Technical Officer. Even though 14 Juki Machines and 03

overlock machines had been purchased it was observed that certain machines were idling as only 10 employees were deployed.

(viii) Even though the loan of Rs.10 million for the establishment of a holiday resort had been granted for the proposed project, business activities had not been started even by 22 March 2013. There were no specific indications that business activities would be started. As such it was observed that the granting of the loan had not resulted in encouraging a small and medium enterprises which is the objectives of the Project.

(ix) Granting of Loans for Creation of new Industries

The objective of the Project is the revival of the small and medium industries beset by the World Economic Depression loan amounting to Rs.237.15 million had been released for 07 new enterprises established. According to the conditions in Section E(b) of Schedule 2 of the agreement relating to the granting of loans exceeding Rs.10 million, there was no possibility of examining the suitability of the new enterprises for the granting of loans.

(f) Performance of the Project Management Unit

Following observations are made.

(i) Even though the Management Unit of this Project should assist the activities of the Warehouse Financing Receipts Project, none of the activities relating to the Project had been carried out despite the signing of the agreement of that Project on 17 July 2012 and a provision of Rs.300 million allocated for the year 2012 for this Project.

(ii) Even though the Project Management Unit had conducted field inspections of 17 small and medium industries and submitted reports on the progress of the investment of money made available, the courses of action taken on the deficiencies of 03 industries included therein had not been disclosed.

