

Revolving Fund of Small and Micro Industries Leader and Entrepreneur Promotion Project III (SMILE-III) - 2013

The audit of financial statements of the Revolving Fund of the Small and Micro Industries Leader and Entrepreneur Promotion Project III (SMILE-III) for the year ended 31 December 2013 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 Section 3 (8) of Article III of the Loan Agreement No. SL – P81 dated 07 December 2004 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Japan Bank for International Cooperation (JBIC).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Operating Instructions of the SMILE III Revolving Fund, the Ministry of Industry and Commerce is the Implementing Agency of the Revolving Fund. The objectives of the Revolving Fund are to promote stable and balanced economic growth in Sri Lanka through providing capital to small and micro industries, developing managerial, accounting, and technical skills of small and micro industries and strengthening institutional capabilities of intermediary financial institutions. According to the Loan Agreement of SMILE III, the estimated total cost of the Project was Japanese Yen 9,619 million it had been financed by JBIC. Under the Section 03 (6) of the Loan Agreement, it was authorized to set up a Revolving Fund III for relending to certain credit institutions in Sri Lanka. The fund accumulated through the process of relending will be used for repayment of main Loan. According to the Operating Instruction, the SMILE III Revolving Fund commenced its activities on 01 May 2012.

1.3 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

2. Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. Audit opinion, comments and findings in this report are based on a review of the financial statements presented to audit and substantive tests of samples of transactions. The scope and extent of such review and tests were such as to enable as wide audit coverage as possible within the limitations of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards to obtain reasonable assurance as to whether the financial statements are free from material misstatements. The audit includes the examination on a test basis of evidence supporting the amounts and disclosures in financial statements and assessment of accounting policies used and significant estimates

made by the management in the preparation of financial statements as well as evaluating their overall presentation and the examination included such tests of systems and controls transactions, assets, liabilities and accounting records as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over Revolving Fund management and the reliability of books, records etc. relating to the operations of the Revolving Fund.
- (b) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Revolving Fund, the progress of the Revolving Fund in financial and physical terms, the assets and liabilities arising from the operations of the Revolving Fund etc.
- (c) Whether funds supplied under the Revolving Fund had been utilized for the intended purposes.
- (d) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Revolving Fund.
- (e) Whether the financial statements had been prepared on the basis of Generally Accepted Accounting Principles.

3. 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 the paragraph 5 of this report, I am of opinion that, the Revolving Fund had maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the state of affairs of the Revolving Fund as at 31 December 2013 in accordance with Generally Accepted Accounting Principles.

4. Financial Statements

4.1. Financial Performance

According to the financial statements and information made available, the total disbursements of the Revolving Fund for the year ended 31 December 2013 amounted to Rs. 184,146,720. The summary of the operations of the Revolving Fund for the year under review is shown below.

Participating Credit Institutions (PCIs)	Amount disbursed for the year ended 31 December 2013 Rs.
----- Commercial Bank (CB)	----- 8,000,000
Development Finance Corporation of Ceylon (DFCC)	34,080,000
National Development Bank (NDB)	14,400,000
Sampath Bank (SB)	13,840,000
Regional Development Bank (RDB)	5,160,000
Hatton National Bank (HNB)	68,315,200
Seylan Bank	37,951,520
Peoples Bank	2,400,000
Bank Of Ceylon	-
Total	----- 184,146,720 =====

5. Audit Observations.

5.1. Accounting Deficiencies

The following observations are made

- (a) Administration and other costs aggregating Rs.4,053,037 incurred in 2012 under SMILE III Project which was closed in 2012 had been transferred and shown as the cost of Revolving Fund.
- (b) Interest receivable amounting to Rs.129,300 on Sub Loans granted on 04 November 2013 by Peoples' Bank had not been accounted for.
- (c) Even though the Revolving Fund had utilized the balance of funds amounting to Rs. 8,902,326,944 brought forward from the SMILE III Project maintained by the Central Bank of Sri Lanka, that fact had not been disclosed in the financial statements as at 31 December 2013.

6. Financial and Physical Review

6.1. Utilization of Funds

The following observations are made

- (a) According to the information furnished under paragraph 4.1 of this report, out of total proceeds of sub loans aggregating Rs.184,146,720 granted by 8 Participatory Credit Institutions, sub loans valued at Rs. 140,346,720 had been granted by 03 participatory Credit Institutions. Further, Bank of Ceylon had not granted any sub loan under this revolving fund arrangement.
- (b) Out of the total allocation of Rs.300,000,000 made by the General Treasury, a sum of Rs.186,554,529 had only been utilized during the year under review for granting sub loans and administrative purposes.
- (c) Even though the Revolving Fund Management Unit had been established in May 2012 disbursements of sub loans had been commenced in November 2013.
- (d) According to the Operating Instructions, the sub loans are expected to grant for two purposes namely, technical transfer and general purposes. However, no sub loans had been granted for technical transfer purposes during the year under review.

The following observations are made in connection with sub loans granted for general purposes.

- i. Only one sub loan had been granted for the industries such as manufacturing of plastics, leather and paper products each and no sub loans had been granted for chemical production purpose which was a selected sector for granting sub loans under general purposes.
- ii. Out of the total disbursement during the year 2013, a sum of Rs. 105.72 million, representing 57 per cent of total allocation had been made only for three sectors such as food processing, beverage and tobacco, metal products and fisheries and the balance of Rs.75.23 million had been disbursed among other 11 sectors indicated that an unequal distribution proceeds of loans for different sectors.
- iii. According to the Operating Instructions of the Revolving Fund, more attention should be drawn to grant sub loans for fisheries, agriculture and animal husbandry sectors. However, the Participatory Credit Institutions had granted only three sub loans for such sectors valued at to Rs.5.59 million representing 3 per cent of the value of total loans granted had been granted.
- iv. Further, it was observed that out of total disbursement of sub loans for general purposes, a sum of Rs. 68,626,720 representing 37 per cent had been granted as at 31 December 2013 to the enterprises located at the Western Province. According to the Operating Instruction, priority should be given to disburse sub loans in rural areas, no sub loan had been disbursed for the enterprises located in targeted areas such as Matale, Nuwara eliya, Monaragala, Trincomalee, Vouniya, Jaffna, Kilinochchi, Mannar etc during the year under review.

7. Systems and Controls

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

- (a) Fund disbursement
- (b) Cash management