

Poverty Alleviation Micro Finance Project -II and Poverty Alleviation Micro Finance Project -II Revolving Fund - 2014

The audit of financial statements of the Poverty Alleviation Micro Finance Project - II and Poverty Alleviation Micro Finance Project -II Revolving Fund for the year ended 31 December 2014 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 4(3) of Article III of the Loan Agreement No.SL-P 94 dated 29 July 2008 entered into between the Democratic Socialist Republic of Sri Lanka and then Japan Bank for International Co-operation, presently known as the Japan International Corporation Agency.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement of the Poverty Alleviation Microfinance Project-II, the Central Bank of Sri Lanka is the Executing and Implementing Agency of the Project. The objectives of the Project are to improve income level of the poor and enhance formal financial service for them by providing credit for income generating activities, improving management and training capacity of the Participating Financial Institutions and the Partner Agencies and increasing income generating opportunities and skills development of beneficiaries, thereby contributing to alleviate poverty, mitigating regional inequity and supporting peace building. As per the Loan Agreement, the estimated total cost of the Project was Japan Yen 2,759 million equivalent to Rs 3,076 million and out of that Japan Yen 2,575 million equivalent to Rs 2,704 million was agreed to be provided by the Japan International Corporation Agency. The Project commenced its activities in January 2009 and scheduled to be completed by December 2013. However, the effective date of the Loan for final disbursement purposes had been extended up to 12 November 2015.

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 Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of the financial statements 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 the Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion. The examination also included such test 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 Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) Whether 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) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loan.
- (e) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (f) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.

- (g) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (h) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (i) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (j) Whether the financial covenants laid down in the Loan Agreement had been complied with.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2014 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2014 in accordance with Sri Lanka Accounting Standards.
- (b) the funds provided had been utilised for the purposes for which they were provided.
- (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) the 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.

2.2 Comments on Financial Statements

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

As per the Operating Instructions of the Project, Project Steering Committee should be met once in three months to determine the policy issues relating to the implementation of the Project. However, only one meeting of the Project Steering Committee had been held during the year 2014.

3. Financial and Physical Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2014 are shown below.

| Source | Amount agreed for financing in the Loan Agreement | | Allocation made in the Budget Estimate for the year under review | Funds Utilized | | | |
|--------|---|--------------|--|------------------------------|---------------|------------------------|--------------|
| | | | | During the year under review | | As at 31 December 2014 | |
| | JPY million | Rs. million | Rs. million | JPY million | Rs. million | JPY million | Rs. million |
| JICA | 2,575 | 2,704 | - | 286.09 | 362.93 | 2,435 | 3,325 |
| GOSL | 184 | 372 | 576 | - | 19.02 | - | 124 |
| | 2,759 | 3,076 | 576 | 286.09 | 381.95 | 2,435 | 3,449 |

Out of the total allocation of Japan Yen 2,575 equivalent to Rs 2,704 million, Japan Yen 2,305 million equivalent to Rs 2,420 million allocated for granting sub-loans for the beneficiaries and the entire allocation thereon had been utilized as at 31 December 2014 for the intended purposes. The allocation of Japan Yen 176 million equivalent to Rs 223.88 million had been made under the Components of Equipment, Consultancy Services and Capacity Development and out of that only Japan Yen 73.9 million had been utilized as at 31 December 2014.

3.2 Issues relating to application of Reimbursement Procedures

The following observations are made.

- Salaries amounting to Rs 14.7 million and other allowances amounting Rs 6.8 million paid to the field officers of the Project during the year under review had not been reimbursed from the Lending Agency even as at 31 December 2014.
- The allowances for the field officers aggregating Rs. 3.3 million incurred before 2014 had been claimed by the Project under the Equipment Component and it was returned by the Lending Agency.

3.3 Physical Progress

The following observations are made.

- (a) According to the paragraph 13 of the Project Memorandum, at least 50 per cent of the allocation made for granting sub- loans is required to be provided to the beneficiaries living in the Northern and Eastern Provinces. However, only 12,286 sub- loans valued at Rs 755.5 million representing 24 per cent of total value of loans granted had been released to the beneficiaries in the Northern Province. Further, the progress of the value of sub- loans granted to the beneficiaries in Killinochchi, Mannar, Vavunia, and Mullativu districts were remained below than 5 per cent of the total value of sub – loans granted by the Project as at 31 December 2014.

- (b) In addition to the above, 20,564 sub- loans valued at Rs 1,070.1 million representing 34 per cent of total value of loans granted had only been released to the beneficiaries in North Western, North Central, Uva and Sabaragamuwa Provinces.

- (c) Further, only 11,859 sub-loans valued at Rs 681 million had been granted by the Project as at 31 December 2014 for the fisheries and small industries sectors whilst 46,545 sub-loans valued at Rs 2,445 million for the other sectors such as agriculture, livestock and trade and services etc.,.

3.4 Revolving Fund

As per the Section 4 (1) of Article III of the Loan Agreement, a Revolving Fund Account had been opened at the Central Bank of Sri Lanka in August 2011. The disbursements for the sub-loan purposes had been commenced in 2013, out of the proceeds of loan recoveries. Therefore, refinance loans valued at Rs 2,748 million had been released by the Revolving Fund as at 31 December 2014.