

## **Small and Medium Enterprises Development Facility -2015**

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The audit of financial statements of the Small and Medium Enterprises Facility Project for the year ended 31 December 2015 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 II B 3 of Schedule 2 of the Financing Agreement of Credit No.4804-LK dated 08 November 2010 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the International Development Association (IDA).

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

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According to the Financing Agreement of Small and Medium Enterprise Development Facility Project, then Ministry of Finance and Planning, presently the Ministry of Finance is the Executing Agency and the Department of Development Finance is the Implementation Agency of the Project. The objective of the Project is the improvement of the accessibility to financing including short term financing to the Small and Medium Enterprises of Sri Lanka affected by the global financial crisis.

The Project consists of the following parts,

#### **(a) Financing and Risk Sharing**

- (i) Carrying out of productive investments for Small and Medium Enterprises through the establishment of Line of Credit for Participating Financial Institutions (PFIs) for the purposes of provision of sub-project Loans to such enterprises.
- (ii) Expansion of access to and terms of finance for Small and Medium Enterprises through the establishment of Lines of Credit for Participating Financial Institution for purpose of provision of sub-project Loans to such enterprises, some of which sub-project Loans to be covered by a Risk Sharing Facility purposed and financed entirely by the Recipient.

#### **(b) Policies and Capacity Enhancement for Small and Medium Enterprise Banking**

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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.

- (i) Providing of support to Project management, implementation, and monitoring and evaluation, including administrative and financing management, procurement and disbursement.

According to the Financing Agreement, the estimated total cost of the Project amounting to SDR 37.8 million (US\$ 57.4 million) equivalent to Rs.8,151.95 million and the total amount was agreed to be financed by the International Development Association. The Project commenced its activities on 01 May 2010 and scheduled to be completed by 31 March 2014. Subsequently, the period of the Project had been extended up to 30 September 2015. However, the financial statements for the year ended 31 December 2015 had been prepared and presented for audit.

### **1.3 Responsibility of the Management for the Financial Statements**

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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**

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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 the 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 opinion. The examination also included such tests 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 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 Credit, etc.
- (d) Whether the opening and closing balances and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date.
- (e) Whether the withdrawals under the Credit had been made in accordance with the specifications laid down in the Financing Agreement.

- (f) Whether the funds, materials and equipments supplied under the Credit 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 Financing Agreement had been complied with.

## **2. Financial Statements**

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### **2.1 Opinion**

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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 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Accounting Standards.
- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balances and withdrawals from and replenishments to the Special (Dollar) Account had been truly and fairly disclosed in the books and records maintained by the Project and the balance as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) 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 Financing 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 Financing Agreement had been complied with.

### 3. Financial Performance

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#### 3.1 Utilization of Funds

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Certain significant statistics relating to the financing, budgetary provisions for the year under review, utilization of funds during the year under review and up to 31 December 2015 are shown below.

Source	Amount agreed to be financed as per Credit Agreement		Allocation made in the Budget Estimate for the year 2015	Funds Utilized during the year under review as at 31 December 2015		
	US\$ million	Rs. million		Rs. million	US\$ million	Rs. million
IDA	57.4	8,151.95	2,400	1,837.25	44.73	6,351.88
GOSL	-	-	10	8.13	0.30	42.52
	<u>57.4</u>	<u>8,151.95</u>	<u>2,410</u>	<u>1,845.38</u>	<u>45.03</u>	<u>6,394.40</u>

The following observations are made.

- (a) According to the above information, out of the total allocation of US\$ 57.4 million equivalent to Rs 8,151.95 million, only US\$ 44.73 million equivalent to Rs 6,351.88 million had been utilized at the end of the period of the Project.
- (b) Out of Rs. 6,654.47 million allocated for the Line of Credit, Rs. 6,543.26 million had been disbursed for 824 sub projects through 08 Financial Institutions. Accordingly 98 per cent of allocation made for Line of Credit had been disbursed at the end of the period of the Project.