

Poverty Alleviation Micro Finance Project –II and the Revolving Fund - 2016

The audit of financial statements of the Poverty Alleviation Micro Finance Project - II and the Revolving Fund for the year ended 31 December 2016 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 Co-operation 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 Participating Financial Institutions (PFIs) and Partner Agencies (PAs) and increasing income generating opportunities and skills development of beneficiaries, thereby contributing to alleviating poverty, mitigating regional inequity and supporting peace building. As per the Loan Agreement, the estimated total cost of the Project amounted to 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 Cooperation Agency. The Project commenced its activities in January 2009 and scheduled to be completed by December 2013. Further, the effective date of the Loan for final disbursement purposes had been extended and completed on 12 November 2015. However, the financial statements for the year ended 31 December 2016 had been prepared and presented for audit.

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 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 etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipment supplied under the Loan had been utilized for the purposes of the Project.
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (g) Whether the financial statements had been prepared on the basis of Sri Lanka Accounting Standards.
- (h) Whether the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (i) 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 2016 and the financial statements give a true and fair view of the state of affairs of the Project and the Revolving Fund as at 31 December 2016 in accordance with Sri Lanka Accounting Standards,
- (b) the funds provided had been utilized for the purposes for which they were provided,

(c) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and

(d) the financial covenants laid down in the Loan Agreement had been complied with.

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 2016 are shown below.

Source	Amount agreed for financing according to the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	JPY million	Rs. million		Rs. million	during the year under review		as at 31 December 2016
	JPY million	Rs. million	Rs. million	JPY million	Rs. million	JPY million	Rs. million
JICA	2,575.00	2,704.00	-	-	-	2,562.00	3,470.00
GOSL	184.00	372.00	65.00	-	53.50	-	252.40
	<u>2,759.00</u>	<u>3,076.00</u>	<u>65.00</u>	=	<u>53.50</u>	<u>2,562.00</u>	<u>3,722.40</u>

3.2 Physical Progress

According to the information collected, the Project had granted 59,215 sub loans valued at Rs. 3,213 million at the end of the previous year through 11 Participating Financial Institutions and out of that 50,076 of sub loans representing 86 per cent of total value of sub loans had been granted through 03 state owned Participating Financial Institutions whilst other 9,139 sub loans representing 14 per cent of the value of sub loans had only been granted by 08 Participating Financial Institutions in private sector. Further, as per the Section 4 (1) of Article III of the Loan Agreement, a Revolving Fund Account had been opened with the Central Bank of Sri Lanka in August 2011 and the operations of the Revolving Fund commenced in 2013. According to the information received, a sum of Rs.1,567 million had been released during the year under review, out of sub loans valued at Rs. 5,647 million granted through 05 Participating Financial Institutions.

3.3 Identified Loss

Impairment loss of Rs. 34.59 million had been recognized in the financial statements of the year under review on the Reverse Repurchase Investment matured on 12 December 2016, due to breach of contractual agreement by a Primary Dealer.