

Smallholder Tea and Rubber Revitalization Project - 2017

The audit of financial statements of the Smallholder Tea and Rubber Revitalization Project for the year ended 31 December 2017 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 Article XI of the Financing Agreement No. 2000001447 dated 26 April 2016 entered into between the Democratic Socialist Republic of Sri Lanka and the International Fund for Agricultural Development.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement of the Project, the Ministry of Plantation Industries is the Executing and Implementing Agency of the Project. The objective of the Project is to develop more productive, profitable and resilient economic activities of Tea and Rubber Smallholders in the Project Area. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 65.40 million equivalent to Rs.8,502 million and out of that US\$ 25.76 million equivalent to Rs.3,349.30 million was agreed to be provided by the International Fund for Agricultural Development. The Project commenced its activities on 15 August 2016 and scheduled to be completed on 23 April 2021.

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 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 and the International Fund for Agriculture Development Guidelines for Project Audits. 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 judgment, 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 withdrawals under the Credit had been made in accordance with the specifications laid down in the Financing Agreement.
- (e) 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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date.
- (f) Whether the funds, materials and equipment 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 Generally Accepted Accounting Principles.
- (i) Whether the 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

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 2017 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2017 in accordance with Generally Accepted Accounting Principles and the IFAD Guidelines,
- (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 2017 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka as at that date,
- (d) the Statements of Expenditure submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Financing Agreement,
- (e) the 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 Financing Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Non-Compliance with Laws, Rules and Regulations

According to the paragraph 1.3 of the Circular No. 1/2016 of 24 March 2016 of the Department of Management Services, a Project should be treated as a foreign funded project if the foreign funding component of the Project should not be less than 60 per cent of the total Project cost. Eventhough the contribution of the International Fund for Agricultural Development for this Project is limited to only up to 39 per cent of the total cost of US\$ 65.40 million and treated as a foreign funded project.

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 2017 are shown below.

Source	Amount agreed for financing in the Financing Agreement		Allocation made in the Budget Estimate for the year under review	Funds utilized			
	US\$ million	Rs. million		Rs. million	during the year under review		as at 31 December 2017
	US\$ million	Rs. million	Rs. million	US\$ million	Rs. million	US\$ million	Rs. million
IFAD	25.76	3,349.30	400.00	1.787	273.84	1.911	292.86
Participating Banks	3.25	422.60	-	-	-	-	-
Beneficiaries			-				
Contributions	3.61	469.20		0.009	1.44	0.009	1.44
Private Parties	0.02	1.90	-	-	-	-	-
GOSL	32.76	4,259.00	900.00	0.185	28.41	0.236	36.27
Total	<u>65.40</u>	<u>8,502.00</u>	<u>1,300.00</u>	<u>1.981</u>	<u>303.69</u>	<u>2.156</u>	<u>330.57</u>

Eventhough the Government had allocated a sum of Rs. 400 million in the Budget Estimate for the year under review under foreign component, the Project had prepared an annual action plan for the year under review to carryout activities of the Project at a cost of Rs. 911 million. Thus indicated the action plan for the year under review had not been prepared reliably.

3.2 Physical Progress

The Project consists of 03 components to provide financial and technical supports to the Tea Smallholders' Development Authority, Rubber Development Department and provide financial facilities through credit schemes implemented by 04 Participatory Credit Institutions. Therefore, the subsidy schemes are implemented by the Project to the support of tea small holders in Galle, Matara, Ratnapura, Badulla, Kandy and Nuwara-Eliya districts for replanting purposes and rubber smallholders in Ampara and Monaragala districts for new planting purposes. The following observations are made relating to the progress of the above mentioned 03 components.

- (a) The total sum of Rs. 330.57 million had been spent to implement the activities of the Project under all 03 components as at 31 December 2017 and out of that only a sum of Rs. 203 million representing 61 per cent of the total expenditure had been incurred to implement the activities of the Project whilst the balance amount of Rs.127.57 million representing 38 per cent of the total expenditure had been spent for project monitoring purposes including staff remuneration of Rs.59.30 million representing 18 per cent of the total cost.
- (b) According to the annual work plan, a sum of Rs. 671 million had been allocated during the year under review to carry out the activities for market driven production support and market diversification for tea smallholders under the component of Tea Smallholders' Development. However, there was no financial and physical progress thereon had been reported even as at 31 December 2017.

- (c) The subsidies aggregating Rs.135.28 million had been granted to the smallholders of tea plantations during the year under review for new planting purposes. However, no records on lands cultivated under grants of Rs.35.65 million had been made available for audit.
- (d) According to the information made available, it was expected to distribute 300,000 rubber plants during the year under review to the smallholders in the Ampara and Monaragala districts for new planting purposes. However, only 93,000 plants had been distributed to the smallholders in those districts.
- (e) The Project had paid a sum of Rs. 1.75 million to the Department of Forest on 23 November 2017 for demarcation and surveying of 280 hectare of forest land in Ampara district in order release those lands to farmers for rubber new planting purpose. However, the activities thereon had not been commenced even up to 31 May 2018.
- (f) According to the Project Work Plan, a sum of Rs. 139.89 million had been allocated for granting credit facilities for tea and rubber smallholders under the component of Rural Financing. However, no action had been taken up to 31 December 2017 to implement the credit schemes under the respective component.