

## **Agriculture Sector Modernization Project - Part 01 - 2018**

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The audit of financial statements of the Agriculture Sector Modernization Project – Part 01 for the year ended 31 December 2018 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 Schedule 2, Section II, B.3 of Financing Agreement No. 5873-LK dated 17 January 2017 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. My comments and observations which I consider should be reported to the Parliament appear in this report.

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

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According to Financing Agreement, of the Part -01 of the then Ministry of Primary Industries, presently Ministry of Social Welfare and Primary Industries is the Executing and Implementing Agency of the Project. The objectives of the Project are to support to increase agriculture productivity, improve market access and enhance the value addition of smallholder farmers and agribusinesses in the Northern, Eastern, North-Central, Central, and Uva Provinces. The activities of the Project are implemented under 03 components namely investment preparation support, matching grants to farmer producer organizations and agribusinesses and partial credit guarantee. As per the Financing Agreement, the estimated total cost of the Project was US\$ 106.97 million equivalent to Rs. 15,612.27 million and out of that US\$ 62.50 million equivalent to Rs. 9,121.88 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44.10 million equivalent to Rs. 6,436.40 million is expected to be financed by the beneficiaries and US\$ 0.37 million equivalent to Rs. 54 million contribute by the Government of Sri Lanka. The Project had commenced its activities under the retroactive financing on 15 October 2016 and scheduled to be completed by 31 October 2021.

### **1.3 Qualified Opinion**

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In my opinion, except for the effects of the matters described in the Table 2.1 of my report the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2018, financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

### **1.4 Basis for Qualified Opinion**

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I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### **1.5 Responsibilities of management and those charged with governance for the Financial Statements**

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Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal

control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Project ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Project or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

The Project is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared by the Project.

## **1.6 Auditor's Responsibilities for the audit of the Financial Statements**

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My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

## 2. Comments on Financial Statements

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### 2.1 Accounting Deficiencies

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	<b>Accounting Deficiency</b>	<b>Impact</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
(a)	Contribution made by the beneficiaries to implement the activities of the Project had not been separately identified and recorded.	Under statement of the Source of Fund.	This amount would be recorded after being released of the loans from the Commercial Banks to the beneficiaries.	The contribution of the beneficiaries required to be identified and disclosed in the financial statements.
(b)	The exchange gain on foreign currency transactions amounting to Rs 231.77 million had been set off against the operational expenditure of the Project.	Understatement in operational expenditure of the Project.	Not properly commented.	Exchange gain to be recorded separately in the financial statements.

### 2.2 Non -Compliance with Laws, Rules and Regulations

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<b>Reference to the Laws Rules and Regulations</b>	<b>Non- Compliance</b>	<b>Impact</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
Circular No. MOFP/ERD/2007/002 of 07 August 2007	Financial statements of the Project for the year ended 31 December 2018 re-quired to be submitted for audit on or before 31 March 2019 had been submitted on-ly on 25 April 2019.	Not comply with the major requirement stipulated by the Circular and the Lending Agency.	Delay due to staff shortage and action would be taken to rectify the error.	Need to comply with the Circular instructions.

### 3. Physical Performance

#### 3.1 Physical progress of the activities of the Project

The activities of the Project consist of 03 sub components of investment preparation support, awarding of matching grants to the Farmer Producers' Organizations and supporting to share the financial risk with Participating Financial Institutions etc,. The following observations are made on the progress of implementation of the activities of the Project.

Component	Expected physical performance as at 31 December 2018	Impact	Response of the Management	Auditor's Recommendations
Awarding of matching grants to the Farmer Producers' Organizations	It was expected by the Project to support to 350 Farmer Producers' Organizations in Jaffna, Mullative, Anuradhapura, Batticaloa, Monaragala, Matale and Polonnawaruwa districts. However, the matching grants aggregating Rs. 579.57 million had only been released to 61 Farmer Producers' Organizations in the above mentioned districts. Out of that only 52.37 million had been granted to 07 Farmer Producers' Organizations in Mullative and Batticaloa districts upto 31 December 2018.	Underutilization of funds allocated	Action will be taken to address this issue 2019.	Prompt action need to be taken expedite to provide matching grants.
Preparation of Investment Proposals	The contracts had been awarded for 02 Technical Service Providers in the Uva, Central, and North Western Provinces . Out of that only a service provider had completed 15 proposals and released a sum of Rs.1.61 million thereon as at 31 December 2018.	Possible delays in completion of the Project activities.	Contracts for preparation of investment proposal had been given for 2 technical service providers which were not up to the requirements.	Action should be taken to evaluate the capacity of the contractor before awarding.
Partial Credit Guarantee	Allocation amounting to US\$ 7.12 million to carry out activities under the component of Partial Credit Guarantee of the Project had not been utilized up to 31 December 2018.	Expected benefits would not be received to Beneficiaries.	Action had not been initiated by the respective Licensed Commercial Banks, due to problems	Action should be taken to get the support to implement the Loan Scheme through Licensed Commercial Banks in private sector

in administrative arrangements.

### 3.2 Idle Resources

	<b>Audit Issue</b>	<b>Impact</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
(a)	Out of the proceeds amounting to US\$ 13.93 million credited by Lending Agency only US\$ 5.87 million had been utilized as at 31 December 2018 Balance of US\$ 8.06 million remained unspent for more than 06 months in Special Dollar Account at the Central Bank of Sri Lanka whilst other balances amounting to Rs.212.79 million remained in the Project, Current Account.	Under-utilization of funds due to poor financial management.	It was estimated to spend US\$ 13.93 million during the specific period. However, the majority of proponents failed to fulfil the eligibility and criteria of the grant.	Need to take action for rectification
(b)	A web- based GIS software procured by the Project in the previous year at a cost of Rs. 4.25 million had not used for intended purposes for over a year	Procurement of assets without pre-planning	Recruitment process of the GIS Consultant is being implemented.	Need to be operated Data Base in comprehensive manner.

### 3.3 Issues Related to Human Resources Management

<b>Cadre Position</b>	<b>No. of Posts</b>			<b>Impact</b>	<b>Response of the Management</b>	<b>Auditor's Recommendations</b>
	<b>Approved</b>	<b>Actual As at 31 December 2018</b>	<b>No. of vacancies</b>			
Project Director	01	-	01	The implementation of the activities of the Project and administration of Project	Action will be taken to recruit suitable officer	Need to take immediate action to recruit persons for key managerial positions

Internal Auditor	01	-	01	Monitoring Unit is paralyzed Monitoring, mechanism over the financial and other controls would be loosen.
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**3.4 System and Controls**

----- <b>Audit Issue</b> -----	----- <b>Impact</b> -----	----- <b>Response of the Management</b> -----	----- <b>Auditor's Recommendations</b> -----
A comprehensive Action Plan of the Project had not been prepared to achieve the objectives of the Project.	Time targets for physical and financial will not be measured to achieve the objectives of the Project.	Out of 687 Projects 81 had been approved by the the dedicated Committee appointed thereon and balance remained in the pipeline till September 2018.	Need of Comprehensive Action Plan is emphasised.