

Smallholder Tea and Rubber Revitalization Project - 2019

The audit of financial statements of the Smallholder Tea and Rubber Revitalization Project for the year ended 31 December 2019 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 9.03 (a) of the Article IX of 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. My comments and observations which I consider should be reported to Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Financing Agreement, the Ministry of Plantation Industries and Export Agriculture is the Executing Agency 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. 8,502.08 million and out of that US\$ 25.76 million equivalent to Rs. 3,349.28 million was agreed to be financed by International Fund for Agriculture Development. The balance amount US\$ 39.63 million equivalent to is expected to be financed by the Government of Sri Lanka Banks (PFIs), Beneficiaries and private Sector. The Project had commenced its activities on 26 April 2016 and scheduled to be completed by 23 April 2021. However, due to start-up delay of initial implementation of the project, the completion date has been extended up to 30 June 2022.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the Table 02 of this report, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2019 and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.4 Basis for Qualified Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs) and the International Fund for Agriculture Development Guidelines on Project Audits. My responsibilities, under those standards are further described in the section of Auditor's Responsibilities for the Audit of the Financial Statements section of this 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

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

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 skepticism 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 the Financial Statements

2.1 Accounting Deficiencies

	Accounting Deficiencies	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	As per the withdrawal applications total disbursement for the year under review was Rs. 819,982,081. However, it was erroneously shown as Rs. 820,094,436 in the financial statements. As a result, the expenditure for the year had been overstated by Rs. 112,355.	Overstatements of expenditure	Agreed and error will be corrected after reconciliation of two accounts.	Action should be taken to rectify the error.
(b)	The Government contribution and non-current assets shown in the statement of financial position as at 31 December 2019 had been understated by Rs. 913,800 due to erroneous accounting treatment.	Understatements of Government contribution and non-current assets	Agreed	Action should be taken to rectify the error.

3. Physical Performance

3.1 Physical Progress on Activities Carried Out by the Project

The activities of the Project consisted with 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 support of tea smallholders 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.

No	Audit Issues	Impacts	Responses of the Management	Auditor's Recommendations
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(a)	According to the Design Completion Report of the Project, it was planned to prepare 5,500	The expected results were not achieved.	Based on the recommendations of the IFAD MTR of June	Planned activities should be carried out within the project

hectares of land by uprooting the existing tea in the selected six districts during the years 2016, 2017, 2018 and 2019. However, no work had been commenced during the year 2016 and only 1,452 hectares of land had been prepared during the years 2017 to 2019. Therefore, the Project had decided to revise the replanting target to 4,500 hectares in the year 2019. However, sufficient works had not been carried out to achieve that target by the end of year 2019. Accordingly, there was a considerable period of delay was observed in implementation of the Project as planned.

2019, the total target of period tea replanting was reduced up to 4,500 hectares. Due to design error occurred in the PDR, a considerable delay in start-up of the project, poor technical support from the technical service provider (TSHDA) etc.

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| (b) | According to the condition of Tea Smallholder Development Authority, Tea should be replanted within two years after upfront payment for land clearance. However, out of 1,037 hectares which upfront payment of Rs. 138 million had been paid in 2017, only 610 hectares representing 58 per cent of hectares had been replanted in the year 2019. | The expected results were not achieved. | Accepted. Majority of the upfront payments had been made in latter part of 2017. Accordingly most of them had been started in May - June season 2018. Therefore only 610ha could be able to replant in 2019. | Action should be taken to monitor the project activities. |
| (c) | Number of 3,331 beneficiaries who obtained permits to replant tea in a total area of 729.77 hectares in the six districts during the period of 2017 to 2018 under the subsidies scheme had not continued their subsidies payments after obtaining upfront payments of Rs 109,263,440 on various reasons such as delay in land measuring, delay in grass planting, planters are retired from the scheme and non-compliance with guidelines. | The expected results were not achieved and it is fruitless cost. | Accepted. It is expected that all upfront receivers (except those who have refunded) will be able to absorb in to the replanting process immediately. | Action should be taken to improve the efficiency of field officers. Farmers should be encouraged to cultivate, otherwise upfront payment should be recovered |

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| (d) | According to the Annual Work Plan and Budget for the year 2019, Project had selected 110 tea societies out of 200 tea societies to distribute tools kits and equipment value at Rs.220, 000 per society to improve their service delivery process, initiate their business activities, and encourage to continue the best practice. According to the procurement plan for the year under review, Although the procurement procedure had to be completed in February 2019, it was not completed by end of the year under review. Therefore the project was unable to achieve any physical progress on tea societies. | Tea Societies were not encouraged to improve their service delivery process. | The procurement process was started in November, 2019 and it was completed by February 2020 as scheduled. Though distribution of tools and equipment for the selected societies was planned to complete by end of March 2020, due to the COVID 19 pandemic, the procurement process could not be able to complete as planned | Planned activities should be implemented within planned period without delay. |
| (e) | According to the Design Completion Report of the Project, it was planned to plant 3,000 hectares of Rubber in the selected two districts during the years 2016, 2017, 2018 and 2019. The Project had identified 5,295 hectares of lands at the end of the year under review. However, Permits for planting had been issued only for 2,575 hectares by Rubber Development Department for new planting and only 2,094 hectares of land were planted up to December 2019 on various reasons such as farmers are retired from the scheme and farmers withdraw to other crops. Accordingly, the project had not been fully achieved the target as planned. | The expected results were not achieved. | The project has already planned and in progress to complete balance target in Maha season of 2020. | Planned activities should be carried out within the project period |
| (f) | The Project had planned to cultivate 1,014 hectares and 780 hectares of rubber plants in the Ampara and Monaragala districts | The delay in the distribution of rubber | Hence the heavy rains experienced during the peak time of the planting season in the said | All activities should be implemented for cultivation on set monsoon. |

respectively during the period of 15 September to 15 December 2019. Although arrangements were made to transport 925,704 to the lands from September 2019, rubber plants of 612,775 had only been transported after one month delay. As a result, Project was unable to achieve the balance target of 34 per cent.

(g) The Project had planted 572.4 hectares of rubber in the Monaragala District during the Maha season 2019 and It was planned to supply 886,075kg of compose fertilizer to the farmers. The following observations are made in this regard.

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| <p>i. Although the distribution of plants was commenced on 12 October 2019 and completed by 15 December 2019, no fertilizer was distributed during the period of plants distribution. Therefore, it was not possible to mix fertilizer with soil when planting.</p> | <p>Plants will not grow properly without mixing fertilizer.</p> | <p>Compost distribution to farm lands were severely affected due to heavy rain, during Maha season,2019</p> | <p>All project activities should be implemented at the appropriate time.</p> |
| <p>ii. The compose fertilizer requirement for 572.4 hectares was 886,075 kg. However, only 747,475 kg was provided to the farmers. Further, It was observed that the balance of 138,600 kg fertilizer could not be supplied to 89.5 hectares or 46,200 plants.</p> | <p>Plants will not grow properly without mixing fertilizer</p> | <p>with the completion of the rainy season, the supply of compost fertilizer rescheduled and delivered to the farmers.</p> | <p>Adequate fertilizer should be provided on time to farmers</p> |

(h) According to the Design Completion Report of the Project, Rs. 422.6 million had been allocated for providing credit Farmers were not encouraged to make the Inclusive rural finance component of the project is one of the key components of the Planned activities should be implemented within planned period

facilities to the farmers through the commercial banks for a self-employment or a short term income generating activities to cover the incomes lost until tea plucking and rubber tapping. However the credit facility was not implemented during the year from 2016 to 2018. Although Project had planned to provide Rs. 20 million credit facilities to the farmers in the annual work plan and budget for 2019, it was not implemented up to 31 December 2019.

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3.2 Fund Utilized Out Side the Project Purposes

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
The Project had purchased 10 double cab vehicles on 04 September 2018 to utilize for the operational activities of the Project in 8 districts and Project Head Office. As a result of one cab which had been allocated to the Nuwara Eliya district had been handed over to the Ministry of Plantation Industries on 21 February 2019, the Project had obtained a vehicle for the use of Nuwara Eliya district on hire basis and paid total hire charges of Rs. 1,126,870 during the year under review.	Project has to incur additional cost.	Necessary action has been already taken to get back said vehicle from the Line Ministry for project activities.	Assets created under the project should be utilized for the purposes of the project.

3.3 Matters in Contentious Nature

Audit Issue -----	Impact -----	Response of the Management -----	Auditor's Recommendation -----
The project had spent a sum of Rs.42 million during the period of 2018 to 2019 to develop the rubber plant nursery belonging to Rubber Development Department at Padiyathalawa in the Ampara	Failure to supplying 250,000 rubber plants per year.	As per the information furnished by Rubber Development Department which is the procurement	Construction works should be expedited to fulfill the required rubber plants production.

District with the capacity of supplying 250,000 rubber plants per year. Eventhough the construction of a tank, irrigation system ,model farm , bud wood nursery , cut back nursery and road network relating to plantation are scheduled to be completed on December 2018 , it was delayed over one year. Therefore, the expected planting capacity could not be able to achieved during the year under review.

entity of development of the padiyathalawa Rubber Plant Nursery under the support of STaRR project , 70 percent of the tank has been completed.

3.4 Issues on Financial Control

No	Audit Issues -----	Impacts -----	Responses of the Management -----	Auditor's Recommendations -----
(a)	Although an amount of Rs. 2,015,806 had been paid without recording in the books of accounts of the project to purchase and transport rubber plants in December 2019, above expenditure was not accounted. Therefore cash balance as at 31 st December 2019 had been overstated and total expenditure for the year under review had been understated by same amount in the Financial Statements.	Overstating the cash balance, understating the expenditure.	Issue had happened due to oversight of entering expenditure due to clerical mistake at the year end rush. Mistake has already been corrected.	All the expenditures during the year under review should be accounted.
(b)	Eventhough the Government had allocated a sum of Rs. 1,120 million in the Budget Estimate for the year 2019 under foreign component and government contribution , the project had prepared an Annual Work Plan and budget for the year 2019 to carry out project activities valued at Rs. 1,301.7 million (without Beneficiaries and Bank Contributions). Therefore, the Budget and annual work plan had not been prepared properly by considering the funding	Targets of the Budget and Action plan cannot be achieved	In compliance to the covenants of the Financial Agreement, AWPB for a new year is to be submitted to IFAD and no objection to be obtained before 60 days of the starting date of the respective financial year. AWPB of the project is mainly to be prepared based on the PDR allocation considering the balance activities to be	Budget and annual work plan should be prepared properly by considering the funding arrangement.

arrangement for the year 2019.

performed during the project duration. National budget allocation GOSL (17) IFAD (12) for the year is confirmed normally in January after the approval of the National Budget. It is obvious that entire allocation of the project was set only after 23.12.2019 Irrespective of the funding arrangement , AWPB was prepared for Rs. 1,302 Mn (for both IFAD Rs.939.15 Mn and GOSL Rs 362.71 Mn) and allocations and required liquidity was received for Rs.1,120Mn.

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| (c) | An Internal Audit for the year under review had not been carried out by the Ministry of Plantation Industries. | Possibility to increase frauds and errors. | The Chief Internal Auditor of the line ministry is vacant from September 2019. | An Internal Audit should be carried out without delay. |
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