

Agriculture Sector Modernization Project -Part 01 - 2021

The audit of financial statements of the Agriculture Sector Modernization Project -Part 01 for the year ended 31 December 2021 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 the 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 Parliament appear in this report.

1.2 Implementation, Objectives, Funding and Duration of the Project

According to Financing Agreement, then the Ministry of Primary Industries, presently State Ministry of Development of Minor Crops including Sugarcane, Maize, Cashew, Pepper, Cinnamon, Cloves, Betel Related Industries and Export Promotion is the Executing and Implementing Agencies 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. 15,612.28 million and out of that US\$ 62.87 million equivalent to Rs. 9,175.88 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44.10 million equivalents to Rs. 6,436.40 million is expected to be financed by the beneficiaries. The Project had commenced its activities under the retroactive financing on 15 October 2016 and scheduled to be completed by 31 October 2021. Subsequently, period of the project had been extended up to 30 June 2023.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the table 2.1 of my report, the accompanying financial statement give a true and fair view of the financial position of the Project as at 31 December 2021, statement of expenditure and its cash flows for the year then ended in accordance with the Generally Accepted Accounting Principles.

1.4 Basis for Qualified Opinion

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

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Generally Accepted Accounting Principles, 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.

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

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 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

2.1 Accounting Deficiencies

The following observations are made.

Accounting Deficiencies	Amount	Responses of the Management	Auditors' Recommendations
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	Rs. million		
(a) Contribution made by the beneficiaries to implement the activities of the project had been erroneously shown under the current liabilities without being shown under the equity of the financial statements.	10.2	Noted and will correct in the next year accounts 2022.	Proper presentation needs to be followed.

- (b) The balance of matching grant control account and matching grant creditors account required to be equal. However, the difference was observed between those accounts in the financial statements. 3.96 Eventhough the reconciliation was done last year, was not able to identify the difference. It is a data entry error when transferring from manual to Sage Accpacc. Action should be taken to identify the difference and rectify the error.

3. Physical Performance

3.1 Physical and Financial Progress of the activities of the Project

Eventhough the objective of the Project is to promote commercial and export –oriented agriculture through attracting and leveraging investments from smallholder producer organizations and agri-enterprises for higher value agriculture production and value addition, the information such as additional export earnings generated and additional jobs generated with the intervention of the Project had not been maintained. However, a sum of Rs.302.9 million had been paid as interest charges to the Lending Agency by the Government of Sri Lanka. It was observed that the original Project objectives had been differed subsequently. The activities of the Project are implemented under 3 components namely.

- (a) Investment preparation support
- (b) Awarding of matching grants to farmers producer’s organizations and agribusiness
- (c) Partial credit guarantee

The following observations are made thereon.

No	Component	Audit Issues	Responses of the Management	Auditors’ Recommendations
(a)	Matching Grants	(i) The matching grant program is expected to support approximately 350 farmer producer organizations in 07 priority districts of Jaffna, Mullative, Anuradhapura, Batticaloa, Monaragala, Mathale and Polonnaruwa which are characterized by high poverty head counts. However, the Project had selected 15 other districts including Colombo. Gampaha, Kalutara, Kurunegala to grants the matching grants and out of the total grants 95.21 per cent were allocated for 15 other districts mentioned above.	The PMU had to consider projects and investments from other districts which had more feasible projects with high investments.	Action should be taken to adhere with objectives mentioned in the Project Appraisal Document in the order to achieve the objective of the Project.

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| <p>(ii) Eventhough the Project had approved a sum of Rs. 5,162.9 million as matching grants to 234 proponent companies up to 31 December 2021, the matching grants had not been released even after laps of period 6 to 48 months from the dates of approval.</p> | <p>The delay is mainly due to the following:</p> <ol style="list-style-type: none"> 1. The proponent's financing is delayed and he is not ready to start the project. 2. The required legal documents are not submitted on time. 3. There was an additional delay, due to the lockdown situation in the country due to Covid. | <p>-Do-</p> |
| <p>(iii) Out of the Rs.9,802 million as approved matching grant for 544 proponent companies in year 2018,2019 and 2020 only Rs. 2,345 million had been released as a first tranche to the 128 companies. Due to incompleteness of agreed works, the second tranche valued at Rs.6,476.8 million had not been released to the 400 respective proponent companies even after laps of period 5 to 15 months from the date of first tranche release for the above companies.</p> | <p>The delay is mainly due to the proponent not being able to expedite the project work which is case sensitive to the nature of project. Also there were unavoidable delays faced by the investor, due to import restrictions levied by the GOSL and also travel restrictions levied across the globe.</p> | <p>-Do-</p> |
| <p>(iv) According to the paragraph 8(b) vi of the Annex 2 of the Project Appraisal Document, the investment proposal and matching grants would be implemented over a period of no more than two to three years. However, out of the approved matching grants for 544 proponent companies valued at Rs. 9,802 million in the year 2017, 2018 and 2020, only 38 proponents valued at Rs.422 million had been completed the investment activities at the end of the year 2021.</p> | <p>The both parties work towards eliminating undue delays and expediting the Tranches within the stipulated parameters.</p> | <p>-Do-</p> |

	<p>(v) According to test checks carried out by audit, it had been revealed that the matching grants of Rs. 98.10 million had been released in year 2017, 2018 and 2019 to 17 companies had been abandoned their project activities and refunded only Rs. 1.35 million at the end of the year under review. As mention in my report for the previous year, the legal action had not been taken against the company by the Project to recover the balance of Rs. 96.75 million at the end of the year under review.</p>	<p>The Monitoring and Evaluation Specialist has maintained the list while doing the monitoring visits from implementation of the project. Based on this we are aware of only 2 projects being abandoned and already steps have been taken to recover the Grants paid.</p>	<p>-Do-</p>
	<p>(vi) According to the 7 Implementation Support Mission on February 2019, urgent to launch appropriate data collection and monitoring arrangements for the outcomes and impact of the grant investment had not been implemented even the date of audit on 3 March 2022.</p>	<p>The M& E specialist was employed in 2019 and proper monitoring is carried out with collection of appropriate data on outcomes and results. The impact of the Grant is separately analyzed per project and quarterly reports are extracted.</p>	<p>Action should be taken to educated responsible parties regarding this and expedite the activities.</p>
<p>(b) Partial Credit Guarantee</p>	<p>It was observed that the 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 2021.</p>	<p>The auditor's view on Partial credit Guarantee is factual and accepted. The funds under PCG is totally controlled and monitored by the Department of Rural Development (DRD) Division of the Central Bank of Sri Lanka</p>	<p>Action should be taken to get the support to implement this loan scheme through Private Banks.</p>

3.2 Contract Administration

Audit Issue

Response of the Management

Auditors' Recommendation

The Project had entered in to an agreement with a consultancy firm to get the assistant to prepare business proposals for micro and small projects. The contract work had been terminated after paying Rs. 8.85 million, due to non-achievement of expected outcome. Further, it was revealed that the 58 business proposals which were prepared with the assistance of the TSP only 09 proponents had been received their first tranche even on date of audit on 03 March 2022.

The payments were made as per agreement and for the satisfied performance and services delivered and payment is justified. Even though BOD approves projects, the Grant release is only after signing Matching Grant Agreement which is only when the proponent is ready to implement the project.

Need to adhere with objective of the Project and to take necessary action to minimize the operational cost of the Project.

3.3 Underutilized Resources

The following observations are made.

No. Audit Issues

Responses of the Management

Auditors' Recommendations

(a) It was observed that only a sum of US\$ 28.8 million equivalent to Rs. 5,482.7 million representing 52 per cent of the total allocation of US\$ 61.19 million equivalent to Rs. 8,869.38 million made by the Lending Agency had been utilized as at 31 December 2021 after lapse of 05 years from the commencement of activities of the Project.

Total expenditure up to 31/12/2021 was Rs 5,482.7Mn which is approx. USD 28.8Mn. The total allocation to ASMP Component 1 was USD 61.19Mn. Total withdrawn was USD 31.8 Mn which is 52% .

The activities of the Project should be properly planned to increase the efficiency of fund utilization.

(b) A web – based GIS software procured by the Project in the year 2017 at a cost of Rs. 4.25 million had not been used for intended purpose over past 05 years.

After recruitment of a consultant with knowledge and experience the package is utilized fully and project is able to get the expected reports and analytical information.

Need to adhere with objective of the Project and the take necessary action to minimize the operational cost of the Project.

(c) The Project had rented out another 02 vehicles without assign the 10 vehicles procured already without identifying the requirement of the Project properly, due to poor management on vehicles. Therefore, the Project had spent a sum of Rs.3.06 million as vehicle rent during the year under review fruitlessly. Eventhough there are two vacancies in drivers, two motor vehicles had been hired without drivers are questionable in audit.

These 2 vehicles were hired for the purpose of field visits where access by motor cars are not possible. The motor cars generally used for Colombo running.

-Do-

3.4 Extraneous Activities

The following observations are made.

Audit Issue -----	Response of the Management -----	Auditors' Recommendation -----
A sum of Rs 2.09 million had been incurred on paper advertisement which was not relevant to the objectives of the Project.	Advertisement for Rs 1.2 Mn – this was calling for applications from unemployed graduates that can be selected as future entrepreneurs who can be engaged in value added development processors which is within the scope of ASMP objectives. Also Rs 403,000/= was for the advertising of Solar powered water pumps which is a budget decision made in 2020.	Need to adhere with objective of the Project and the take necessary action to minimize the operational cost of the Project.