

## **Agriculture Sector Modernization Project -Part 02 - 2021**

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The audit of financial statements of the Agriculture Sector Modernization Project -Part 02 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**

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According to the Financing Agreement, the Ministry of Agriculture is the Executing and Implementing Agency of the Agriculture Sector Modernization Project – Part 02. The objectives of the Project are to support to increase agriculture productivity, improve market access and enhance value addition of smallholder farmers and agribusinesses in Jaffana, Mullativu, Anuradhapura, Batticaloa, Monaragala, Matale and Polonnaruwa districts. Further, the activities for the support for smallholder farmers to produce competitive and marketable commodities, improve their abilities to respond to market requirements and move towards commercialization are expected to be carried out under the Agriculture Sector Modernization Project – Part 02. As per the Financing Agreement, the estimated total cost of the Project amounted to US\$ 64.87 million equivalent to Rs. 9,175.88 million agreed to be provided by the International Development Association. In addition, Euro 25 million equivalent to Rs. 5,040 million had been received from the European Commission Trust Fund to implement the activities in other districts such as Kandy, Ampara, Kilinochchi and Vavunia. The Project commenced its activities on 01 January 2017 and scheduled to be completed by 31 December 2021.

### **1.3 Opinion**

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

### **1.4 Basis for 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 and fair presentation of these financial statements in accordance with Generally Accepted Accounting Principles and for such internal control as the management determines as necessary to enable the preparation of financial statements that are free from material misstatements, 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

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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. Physical Performance

### 2.1 Physical and Financial Progress of the Activities of the Project

The activities of the Project are implemented under 5 components namely

- (a) Modern Agriculture Technology Parks
- (b) Analytical and Policy Advisory Support
- (c) Farmer training and Capacity Building
- (d) Production and Market Infrastructure
- (e) Project Management, Monitoring and Evaluation

The objectives of the Project are to support increasing agriculture productivity, improving market access, enhancing value addition of smallholder farmers and agribusiness in the Project areas. According to that whole objective of the Project is to empower the farmers, create employment, attracting youth to modern agriculture. Eventhough 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 following observations are made thereon.

Components	Activities	Audit Issues	Responses of the Management	Auditor's Recommendations
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(a) Modern Agriculture Technology Parks	Design, establish operate, manage and transfer of 07 Modern Agriculture Technology Demonstration Parks in 07 District	As mentioned in the the PAD and TOR of the consultant, high value products or new varieties products had not been introduced to the farmers. Instead of that the crops such as banana, mango, guava, pineapples and chilli had been selected to grow. However, it was revealed that the approved proposed technologies were not new for Sri Lanka and the International Market had not been introduced even on the date of audit on 01 March 2022.	In the feasibility study, ISP has identified crops of high value market-oriented, high yielding, ecologically suitable and potential to grow in selected area for the selected crop clusters. Tropical fruit varieties have been identified as the high value crops as there is a growing demand for them in the international markets for fresh and value added products.	Action should be taken to adhere with objectives mentioned in the Project Appraisal Document in the order to achieve the objective of the Project.
(b) Analytical and Policy Advisory Support	Policy Development	A sum of US\$ 4.28 million equivalent to Rs.624.67 million had been allocated under the component to develop policies. Accordingly, 08 contracts had been awarded to	The final reports on Analytical and Policy Advisory Support have been received and it has now being planned to conduct a Policy Forum to discuss the outcome	Action should be taken to educated responsible parties regarding this and expedite the activities.

consultancy firms at an estimated cost of Rs. 69.55 million and a sum of Rs. 65.58 million had been paid as at 31 December 2021. However, the final reports thereon had not been submitted at the end of the year under review.

these reports with the stakeholders. Although, US\$ 4.2 million was earmarked under this sub-component, it was subsequently revised to US\$ 1.0 million.

(c) Farmer Training and Capacity Building	Farmer Training	Eventhough a sum of Rs. 50.2 million incurred on farmer training on previous years training programmes, it had not been completed as expected. Further, farmer training programmes had not been commenced under the International Service Provider even on the date of audit on 03 January 2022.	The FBS Training has been conducted for Pilot Clusters and those programs included 31 sessions of 3 hours per day. So in order to complete those 31 sessions, Physical training programs were conducted. In these sessions, It was found poor attendances and the participation of alternative members, due to long duration of 31 days.	The action is required to be taken to influence the International Service Provider to comply with the requirements of the contract agreement.
(d) Production and Market Infrastructure	Upgrade and rehabilitates production and market infrastructures	Due to delay in appointment of an International Service Provider, the Project had incurred a sum of US\$ 6.15 million to rehabilitates rural roads, rural tanks, agro wells and storage facilities under pilot project areas. However, the construction works under the Modern Agriculture Technology Demonstration Parks had not been commenced even at the date of audit on 03 January 2022.	Under the Sub component 2.3 production and market infrastructure there are three main activities mentioned in the Project Appraisal Document. (PAD) up-grading and rehabilitation of small-scale irrigation infrastructure and existing water tanks and irrigation systems, improvement of selected production and market access roads and construction of new field access tracks.	Action to be taken to adhere with objectives mentioned in the Project Appraisal Document in the order to achieve the objective of the Project.

## 2.2 Contract Administration

The following observations are made.

No.	Audit Issues	Responses of the Management	Auditor's Recommendations
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(a)	<p>The contract for providing consultancy services for Agriculture Technology Demonstration Parks had been awarded at an estimated cost of US\$ 4.09 million equivalent to Rs.271.94 million on 16 October 2019 and expected to be completed by 31 December 2021. However, it had not been completed even at the date of audit on 05 January 2022 and a sum of Rs. 183 million had been paid thereon as at 31 December 2021. The following observations are made.</p> <p>(i) As per the sub clause 29 of the section 29 of the chapter D, it was agreed to deploy 4 numbers of key International Consultant and 2 numbers of National Consultant for whole contract period. However, the contractor had deployed only one international consultant during the period from 2019 to January 2022 as a team leader.</p> <p>(ii) Other than the above key staff contractor, agreed to deploy well qualified and experienced staff to carry out the activities in the Project areas under this contract agreement. However, test check carried out in audit in the field had revealed that the adequate staff had not been deployed even at the date of audit on 03 January 2022.</p> <p>(iii) Out of 20 Cluster Development Plan, Only 1 Cluster Development Plan had been approved even on the date of audit on 03 January 2022.</p>	<p>It is relevant to note that the nation and international travel restrictions imposed, due to the Covid 19 situation was the major Contributory factor for this issue.</p> <p>Now the District Coordinators and Cluster Coordinators have been appointed by the Consultant.</p> <p>In terms of the Original Contract entered with ISP, all Cluster Development Plans should have been submitted at once. With the view of ensuring the implementation of ATDPs as planned, it was agreed by the both parties to submit and accept CDPs individually.</p>	<p>The action is required to be taken to influence the International Service Provider to comply with the requirements of the contract agreement.</p> <p>-Do-</p> <p>-Do-</p>

- (iv) Eventhough these contract period of the International Service Provider was expired on 31 December 2021, necessary actions had not been taken to extend the contract period, period of the performance bond, Insurance and bank guarantee related to the advance payment. To the validity period of ISP contract, It wanted to be revised the payment schedule of ISP and it was extended to submit the revised payment schedule until 31st of January 2022 by Secretary and after revising it agreement was signed by the ISP giving extension up to end of June 2023. Prompt action should be taken to extend the contract period, performance bond, Insurance and bank guarantee related to the advance payment.
- (v) Eventhough a police study has been done with the expenses of Rs. 2.99 million, the suitable farmer producer organization had not been finalized even the date of audit on 06 June 2022 and still the farmer producer organization had been established under the Department of Agriculture. Further, it was revealed that those farmer societies have no legal bindings, no constitution and they will not be accepted by the Registrar of Companies. Therefore, once the Project support is over, all the farmer organization might be collapsed. According to the Project concept, Farmer Producer Organization should be formed before implementing the cluster activities. A policy study was done to identify the most appropriate farmer business model for ATDPs. This study had highlighted the draw backs of Farmer Producer Organizations (FPO) and evaluated other options for this purpose. After evaluating, all possibilities, it was decided to establish Un-listed Public Companies for ISP Clusters. Action to be taken to adhere with objectives mentioned in the Project Appraisal Document in the order to achieve the objective of the Project.
- (b) The contract for design, develop, install and maintain a Beneficiary Information System had been awarded at an estimated cost of Rs.8.25 million on 28 October 2018 and expected to be completed by 27 February 2019. Even though, a sum of Rs.1.65 million and Rs 3.4 million had been paid in year 2019 and 2020 respectively, the respective works had not been completed even on the date of audit 30 December 2021 after lapse of 38 months. All modules were included in this M & E MIS system. Initially we need to enter Action Plans and Its Progress through this MIS as well as reports related to Action Plan and Progress. Other than to that this MIS included additional modules like Life Cycle, Life Cycle Viewer etc. At present MIS is functioning and it is ready to Enter Action plans and can be taken out as reports. As well as it can used to enter progress Monthly. This is doing in Year 2022. Sound and effective contract management system need to be implemented on monitoring and supervision of the works carried out by the contractor.

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| (c) | <p>The contracts on farmer business school training and farmer producer organization training awarded at an estimated cost of Rs.100.78 million in the year 2019 and 2020 and a sum of Rs.50.2 million had been paid to the service provider at the end of the year under review. According to the information made available, the training programs had not been completed as expected levels, due to poor planning of service provider, deficiencies in selection process of farmers and lack of participation on training programmes.</p>   | <p>The FBS Training has been conducted for Pilot Clusters and those programs included 31 sessions of 3 hours per day. So in order to complete those 31 sessions, Physical training programs were conducted. In these sessions, It was found poor attendances and the participation of alternative members due to long duration of 31 days. The situation was aggravated due to spread of COVID 19 epidemic. therefore, physical training was not possible.</p> | <p>Action is required to be taken to influence the International Service Provider to comply with the requirements of the contract agreement.</p>    |
| (d) | <p>According to the audit test check carried out in North Central Province, the Lands which have 30 acres in Borawewa, 25 acres in Neluwewa, 3 acres in Ratmalthenna and 5 acres in Bogaswewa respectively had been selected for cultivation of chilli. However, none of those lands have survey plans, clear demarcation of land allocated, allocation of 0.5 acre to each beneficiary. However, the Project had not entered into a Memorandum of Understanding between the Mahaweli Authority of Sri Lanka and the beneficiaries for land use. Without any of these, land clearing and preparation works contract had been awarded at a cost of Rs.16.2 million and paid a sum of Rs. 7.7.million during the year under review. However, the respective works had not been completed even at the date of audit on 03 January 2022.</p> | <p>Comment not given.</p>  | <p>Sound and efficient contract management system need to be implemented on monitoring supervision of the works carried out by the contractors.</p> |

### 2.3 Underutilized Resources

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**Audit Issue**

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**Response of the Management**

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**Auditor's Recommendation**

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According to the information made available, the physical and financial progress of the Project had remained moderately satisfactory level. Therefore, out of the allocation of US\$ 62.5 million equivalent to Rs. 9,121.88 million made under the Loan, only US\$ 25.8 million equivalent to Rs. 4,649.4 million representing

The observation of the Auditor General is admitted. Although this project was commenced in 2017, the project could not be implemented as planned, due to the reasons beyond the control.

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

50.9 per cent of the total allocation had been utilized as at 31 December 2021 after lapse of 05 years from the commencement of activities of the Project. Further, the Project expanded its geographical coverage including Badulla, Kilinochchi, Ampara and Vavuniya in year 2020 with the assistance of Euro 25 million grant from the European Union. However, due to low utilization of funds, a sum of Rs. 1,050 million had been allocated to the public institutions which are remained under the Ministry of Agriculture during the year under review.

#### **2.4 Extraneous Activities**

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##### **Audit Issue**

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It was observed that the Project had incurred aggregate amount of Rs 0.74 million to procure smart TV for office of the State Ministry of Agriculture and Independence Day paper advertisement.

##### **Response of the Management**

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As per the provision in PAD, it is a condition to provide awareness to the public on the affairs of project activities.

##### **Auditor's Recommendation**

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Action should be taken to minimize the operational cost of the Project