

Agriculture Sector Modernization Project – Part 01 - 2023

The audit of financial statements of Agriculture Sector Modernization Project – Part 01 for the year ended 31 December 2023 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 the Financing Agreement, the Ministry of Plantation 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\$ 105.15 million equivalents to Rs. 20,051 million and out of that US\$ 61.05 million equivalents to Rs. 11,700.61 million was agreed to be financed by the International Development Association. The balance amount of US\$ 44.10 million equivalents to Rs. 8,451 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 31 December 2024.

1.3 Opinion

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2023, statement of expenditure and its cash flows for the year then ended in accordance with Generally Accepted Accounting Principles.

1.4 Basis for 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 Non Compliance with Laws, Rules and Regulations

Reference to the Laws, Rules and Regulations	Audit Issue	Responses of the Management	Auditor's Recommendation
(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka			
(i) F.R. 396	Three cheques of total valued at Rs.2.3 million issued by the project had passed 6 months since the date of issue. Those cheques were not presented to the bank by 31 December 2023, action had not been taken by the project.	According to the bank reconciliation June 2024 only two cheques are exceeding Six-month, will take action ref. F.R. 396	Action should be taken according to Financial Regulation.
(ii) F.R.756	The appointment of the Annual Board of Survey should be done on or around 15 December of every year. Annual Commodity Board of Survey had not been appointed.	ASMP is in agreeable with the report. Nevertheless, we have appointed committee to the carry out the BOS in January 2024	The appointment of the Board of Annual Commodity Survey should be done according to Financial Regulation.
(iii) F.R. 757 - 1(b) and 2(b)	The Board of Survey should check every article with the balance shown in the Inventory Book as at the date of verification and enter any difference found, on Form T. & A. 66, which should be submitted in quadruplicate. A copy of the form should thereafter be forwarded to the department concerned to be filed as an inventory voucher in support of the adjustments. It was observed that the Inventory survey members had not followed FR 757 1.(b), 2.(b) during the survey.	Agreed that, there are some mistake in the BOS 2023. ASMP assume that next BOS will carry out in accordance with the guidelines stipulated.	Action should be taken according to followed The Board of Survey should check every article with the balance shown in the Inventory Book.

(iv)	F.R. 760	The procedure to be followed is laid down in F.R. 102 et, seq. Stores should be written off the Inventories, Stock Books, etc., with the due authority. Above procedure had not followed properly.	Agreed that, there are some mistake in the BOS 2023. ASMP assume that next BOS will carry out in accordance with the guidelines stipulated	Action should be taken to laid down update inventory books according to Financial Regulation.
(b)	Circular No 01/2019 dated 15 March 2019 issued by the Department of Management Services	National Steering Committee (NSC) meeting should be held once in two month. However, only three NSC meetings had been held during the year under review.	It is not the National Steering Committee that needs to be changed, but the Project Steering Committee. Project steering committees were not previously established, and board meetings were the main forum for discussing issues.	Committee (NSC) meeting should be held according to the circular.
(c)	Circular No SEC/2022/E/03 dated 23 December 2022 issued by Department of Inland Revenue	5 percent of WHT should have been deducted on monthly contract above Rs.100,000. The project has contracted to pay Rs.150,000 monthly for GIS Consultant. It was observed that the WHT amount of approximately Rs.81,000 has not been deducted and paid to the Inland Revenue Tax Department in relation to the Rs.1.62 million paid by the project for GIS Consuler for the year 2023.	In further action will be taken accordingly circular SEC/2022/E/03. It was instructed to PMU.	Deducting and paying WHT should be done according to the circular.

03. Physical Performance

3.1 Physical and Financial Progress of the Activities of the Project

Audit Issue	Responses of the Management	Auditor's Recommendations
(a) The project commenced on 17 January 2017 and scheduled to be completed 86 percent target progress as at 31 December 2023 however it was reported only 69 per cent overall physical progress as at 31 December 2023.	Under ASMP – Component 1, the number of approved sub-projects as of 2023.03.31 was 1,424. However, as of the date of consideration, only 672 projects had completed their work and received financial	Tasks should be completed within the pre-determined time frame.

	disbursements. Additionally, 666 sub-projects had achieved approximately 50 percentage physical progress in stages. Therefore, I acknowledge that as of 2023.12.31, only about 69 percentage progress had been achieved.	
(b)	Due to inefficiency for the traditional rice cultivation project and hygienic and high quality rice noodles production project, government had lost the benefit of Rs.12 million of cost incurred by the government.	As ASMP1 has verified that this company hasn't received any Government Grant, before the approval of ASMP Matching Grant and ASMP1 is not responsible for the Grant given by SAPP after 8 months from ASMP Grant.
(c)	Agriculture Sector Modernization Project-Part 01 has signed an agreement with Parabowa Exports (Pvt) Ltd on 19 February 2019 for setting up a fully automatic rice noodles making machine at a cost of Rs.10 million agreed to provide grants as at 31 December 2023, 90 percentage of the contracted amount had been paid, however, the production of noodles from rice had not been commenced.	As per the Matching Grant Agreement, ASMP1 has signed with Parabowa Exports (Pvt) Ltd., 1st and 2nd Tranche of approved grant had to be disbursed based on the achieved progress of implementation of agreed project activities. Hence, Rs.9 million had been disbursed, after verification of achieved physical progress of 1st and 2nd Tranche activities.
(d)	Production of noodles had not been started by Parabowa Exports (Pvt) Ltd due to wiring and lighting had not been fully completed in the building where the noodles manufacturing machine was installed. The main objective of the implementation of Agriculture Sector Modernization project-Part 01 that is to direct the production of agricultural products to the local and foreign markets was not done and the expected export income was not achieved.	The company has now been started commercial operations of manufacturing rice noodles, few weeks ago, after obtaining ITI test reports, and the products, 200g consumer packs of Spaghetti (red and white) and Vermicelli (red and white) will be released to the market by next month after receiving the printed packing material by the company.
(e)	Nutri Crop (Pvt) Ltd was established on 17 April 2019 with the aim of manufacturing natural ingredients for local and international food, cosmetics, hospitality and pharmaceutical markets, earning USD 600,000 per year in foreign exchange,	Although commercial production was not commenced by December 2023, due to the inability of obtaining three-phase electricity for factory operation, the factory operations has already been started

Facts should be uncovered through local governmental officials such as Grama Sewa Officer and divisional secretary.

To get the confirmation the expected tasks should be completed within the target time and payment release the beneficiaries.

ASMP Part 01 should work to achieve the objectives of the project.

Expected tasks should be completed within the target time.

obtaining GMP, ISO, HACCCP, BRC organic and fair trade certifications, generating direct and indirect employment opportunities in the area. The company has contracted with Agriculture Sector Modernization Project on 20 July 2021 to receive matching grant of Rs. 15 million. Out of which Rs. 13.5 million had been given by 31 December 2023. But Nutri Crop (Pvt) Ltd had not started production till 31 December 2023.

when Regional Matching Grant Manager visited the project in March 2024.

(f) Observation related to Stay Naturals (Pvt) Ltd

On 31 December 2020, Agriculture Sector Modernization Project was contracted to provide a matching grant of Rs.77.93 million with Stay Naturals (Pvt) Ltd to produce value-added essential oils using Sri Lankan spices and develop the management process according to future supplies. The first matching grants tranche of Rs.50 million was given in three days before the signing of the agreement, i.e. on 28 December 2020. As at 31 December 2023, the second and third matching grants tranches were not granted. Thus, it was observed that the desired objectives of providing matching grants had not reached.

After submission of required documents related to the sub-project by the proponent, two Managers in the PMU, Legal Manager and Finance Manager study the documents pertaining to their subject area to give legal clearance and financial clearance.

The project should be properly evaluated before starting and checks should not be written before the contract is signed. Public funds should be used transparently

(g) Observation related to Nevil Industries (Pvt) Ltd

Nevil Industries (Pvt) Ltd which is a company manufacturing agriculture industry machineries, was contracted with Agriculture Sector Modernization Project on 06 June 2023 to receive a matching grant of Rs.30 million to achieve 8 objectives including manufacturing of agro-industrial machineries, providing consultancy services for the small and medium scale industries for effective composted fertilizer production, supporting Sri Lankan economy through local production, developing advance machineries through continuous research and development process. It was observed that the company had failed to

By 31st December 2023, only about 06 months have passed since releasing the first tranche of the matching grant on 6th June 2023. Eight objectives cannot be achieved when investing for the activities related to 1st tranche only and this should be after completing the total investment. The construction of the factory building has been completed by now and machines pertaining to tranche 1 have also been purchased and installed in the factory. Documents and bills related to settling tranche 1 have been

Efforts should be made to achieve the desired objectives within the target period

achieve the above objectives by 31 December 2023.

submitted by the grantee and arrangements are being made by the ASMP to release the second tranche.

- (h) Green Aqua Production (Pvt) Ltd which aims to start a feed production factory for shrimp farming has contracted with Agriculture Sector Modernization Project on 07 February 2022 to receive a matching grant of Rs. 93.8 million for purposes of providing low-cost & better-quality feed for local shrimp farmers, fulfilling 25 percentage of total shrimp feed requirement of the country, creating sustainable supply chain for raw materials and creating new employment opportunities in the area and farming area. As at December 2023, Rs.84.42 million had been received as the first and second grant tranches. By 20 October 2023, only 35,000 kg of shrimp feed had been produced and thus, the objectives of the company were in a poor condition. The Government of Sri Lanka had lost the benefits of the project due to the non-achievement of the desired objectives from the grants given by the Government of Sri Lanka.

The construction work has been delayed due to the foreign exchange crisis and construction material scarcity. This construction is a complex and worth of over Rs 80 million. This became more challenging and demanded more time than expected. It is also noted that construction has been continued even under the second tranche activities as planned. By the time when the Regional Matching Grant Manager undertook the field inspection in February 2024, building construction was completed and the grantee reported that the production has already been commenced in August 2023.

Efforts should be made to achieve the desired objectives within the target period

- (i) Eco Envi Lanka (Pvt) Ltd was commenced to establish production facilities to produce organic substitutes for bio-degradable polythene and plastic by sourcing local raw materials. The company had entered into an agreement with Agriculture Sector Modernization Project on 25 November 2021 to obtain matching grant of Rs.24.89 million. As at 31 March 2022, first and second grant tranches of Rs. 22.40 Mn had been obtained. The third grant tranche was not obtained as at 31 December 2023. It had not been achieved the company's objectives which were to enter the export market, promote traditional handicraft production, produce substitutes for imported plastic raw materials and enter the market successfully.

It has taken more than a year for the construction work and installation of the machines of this company and this situation is quite normal considering the economic crisis and also experienced gathered with other similar sub-projects under the ASMP. Releasing third tranche is pending at the PMU as the grantee has submitted required documents to settle second tranche expenses and it is a matter of PMU staff to check and verify the documents submitted by the grantee.

The project should work to achieve the identified objectives within the expected time.

(j) Observation related to Wanathavilluwa Organic Cashew Ltd

The grant application submitted on 02 March 2020 for Wanathavilluwa Organic Cashew Ltd had been approved by the Project on 01 December 2022 that was 21 months later. Out of approved Rs. 32.40 million, first grant tranche of Rs.9.72 million had been issued on 28 April 2023 and the second and third grant tranches had not been issued till 31 December 2023. Accordingly, the company had not started business activities by 31 December 2023.

Board approval for the project was obtained on 1st December 2022 for 54 members in the Wanathavilluwa Organic Cashew Limited (company). After the Board approval due to the inability of meeting own financial contribution by 9 members, the company has cancelled the membership of those 9 members. In its place, another 9 members joined the company and the documents pertaining to those new members were submitted to the PMU. The second tranche was issued on 25.6.2024.

Efforts should be made to achieve the desired objectives within the target period.

3.2 Contract Administration

Audit Issue	Response of the Management	Auditor's Recommendation
(a) The GIS Consuler of the project has not submitted his work done report to the management from December 2023 till the date of audit. Therefore, the GIS Consultancy fee of December 2023 amount of Rs.150,000 has not been accrued. Accordingly, it was observed that the amount to be paid in relation to the GIS Consuler's duties has not been correctly reflected in the financial statements and the project has not properly supervised his work.	It was also advised to the project's GIS consultant that he had not yet submitted his work-done reports. When needed, the GIS consultant works hard and accomplishes his tasks on the weekends. He has made a significant contribution to the project. He has, however, committed to sending in his work-done reports immediately.	The activities of project should be properly planned to increase the efficiency of consultancy.
(b) Cheques value of Rs.20.84 million for four matching grant has been written in 2022 but those cheques were not issued and were in hand until 2023. It was observed that those cheques had been cancelled in the year of 2023 and that amount was included as grant refund in financial statement 2023. As a result, financial progress as at 31 December 2022 was overstated by that amount.	Cheques were written and not handed to proponent over due to the reason of not stability of proponent. If paid getting refund difficult, to avoid the risk it was done. It was over status 2022 financial statement anyway ultimate result of financial statement 2023 is in a correct manner.	Funds should be released when completed all requirement fulfil.

3.3 Idle/ Unutilized/ Underutilized Resources

	Audit Issue	Responses of the Management	Auditor's Recommendations
(a)	The project commenced on 17 January 2017 and considering the progress of utilization of funds as at 31 December 2023, it was observed that the project utilized only USD 43.32 million funds out of allocation of USD 61.05 million by the IDA Loan. As a percentage, it was 70 percent. Therefore, it had been observed the utilization of funds is ineffective when considering the rest of one year time period with balance funds.	Project was restructured in July 2023 and total project value as reduce to USD 48.620 million according to the fresh project value almost achieved 80 percentage of financial progress.	The identified target of the project should be completed within a specific time frame.
(b)	It was observed that the project has utilized only Rs. 1,275 million from allocation for the reimbursable foreign loan of Rs.4,000 million for the year under review. Therefore, allocation of Rs. 2,724 million representing 68 percent of the total allocation had not been utilized by the project.	GOSL allocation under foreign loan (12) LKR 4000 million and utilized LKR 1,275million. The balance of the allocation is LKR 2,724 million. However, the loan allocation of USD 48.620 Mn could be utilized Within the project period of 31/12/2024.	The target of the project should be completed within project time frame as planned.

3.4 Matters in Contentious Nature

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	ETF surcharge of Rs.66,218 were paid due to delay payment of ETF contribution for the months of March, April and May 2023. The project had paid this amount on 8 April 2024 without successful negotiating with Employees' Trust Fund Board.	To avoid the delays in the payment of ETF presently we are paying ETF online and update without any delay.	The activities of project properly planned to increase the efficiency of fund utilization.
(b)	According to the information, 99 small scale projects and 65 large scale projects were completed as at 31 December 2023. It was observed that any completion report for the completed projects according to the project agreement was not prepared by Agriculture Sector Modernization project as at date of the audit.	There is a completed report and a field test conducted. It was shared with the RMGMs in electronic form, along with instructions for them to send it to proponents who have finished their work. Proponents are now responding to the messages.	The project should work towards achieving the objectives.

3.5 System and Controls

No	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	Vehicles running charts were not properly maintained. And also, vehicles running charts for five vehicles were not submitted for last six months of 2023. It was observed that overtime (OT) and allowance for travelling expense (bata) of those vehicle drivers for last six months to be paid by the project but had not been paid by 15 July 2024.	Accepted. Those five vehicles running charts were questioned and are available for submission. According to the confirmation from ASMP drivers they have claimed (before the 15th of July 2024) all the OT and Bata payments for the above-mentioned vehicle respectively.	Vehicle running chats should be maintained up-to-date and employee allowances should be done properly.
(b)	Celata Tech (Pvt) Ltd had submitted a project proposal to establish a computerized data system called Agro-Bizz with the aim of introducing a more effective method by overcoming the existing weaknesses in the field of agricultural products marketing. An agreement was made with Celata Tech (Pvt) Ltd on 30 December 2020 to provide a matching grant of Rs.37.860 million by Agriculture Sector Modernization Project for that project proposal. The project had paid Rs.34.074 million as first and second grant tranches without physically inspecting the technical equipment purchased for the invoices presented as had been purchased by Celata Tech (Pvt) Ltd by using the grant.	Celata Tech (Pvt) Ltd. Was approved a Max. Matching Grant of Rs.37.86 million To implement a Smart Agro integration platform and signed the Matching Grant Agreement on 30th Dec. 2020 and Rs.18,825,450 was released as 1st Tranche of approved Matching Grant after verifying the required balance funding from own contribution. Rs.11,241,800 was released as revised 2nd Tranche of approved grant, after verifying the achieved financial and physical progress on 29th June 2022. So the total grant amount disbursed is Rs.30,067,250. As the progress of implementation of the project is unsatisfactory, PMU has followed up on progress and conducted several meetings with the company and informed them to complete the activities without further delay.	Funds should be used transparently.
(c)	According to the project proposal presented by Celata Tech (Pvt) Ltd and the agreed project goals of Agriculture Sector Modernization Project, the Agro-Bizz project for a period of five years had clearly stated the goals to be achieved in each year separately. Although three years had passed since the project was started	PMU has verified that the company failed to achieve the expected physical progress and referred the project to the Internal Auditor. Final notice has been sent to the company directors under the registered post to refund all the received grant funds along with the applicable interest as well. (Total amount to be refund	The project tasks must be completed within the planned time frame.

by December 2023, but it had failed to reach the stated goals to be achieved at the end of the first year. Rs.43,861,252 Legal actions will be initiated to recover the disbursed grant funds if the company failed to refund the received grant funds as informed.

3.6 Matters pointed out in Previous Audit Reports which remained unresolved

Audit Issue	Response of the Management	Auditor's Recommendation
<p>Even though an approval has been obtained for the procurement of rope grinding machines worth Rs.700,000 for the 50 members of the Palanthriyagoda Ekamuthu Kapruka Society through the cluster project of FPG/CO/2020/2/24 under Board of Directors Paper No.2019/021/1/02-04, an amount of Rs.2,424,000 was credited to 202 people exceeded the groups approved at Rs.120,000 each on 25 November 2020. The progress on the cluster of entrepreneurs created in relation to rope products had not been inspected and reported by the Southern Provincial Matching Grants Manager.</p>	<p>The FGD/CO/2020/2/24 cluster project received approval for Rs. 2,828,000 for 202 individuals. Under the Ministry of Plantation, the "Kapruka Fund Management Board" has been in responsible for coordinating the "Palanthriyagoda Ekamuthu Kapruka Society" project (Annexure I). Furthermore, they carried other data and information, and it was noted that the PMU trusted the above board because of the government-affiliated institute. As a result, the money was made available at the board's request. However, the RMGM in Southern told the PD in March 2021 that the coordinating officer had been moved, and they asked to be involved in identifying a board officer who would take responsibility for the matter (Annexure II). It has been noted that PMU has not been contacted about this issue since.</p>	<p>The work should be under the supervision of the concerned responsible officers.</p>