Agriculture Sector Modernization Project – Part 02 -2024

The audit of financial statements of the Agriculture Sector Modernization Project – Part 02 Project for the year ended 31 December 2024 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 Agriculture 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 value addition of smallholder farmers and agribusinesses in Jaffana, Mullaithivu, Anuradhapura, Batticoloa, Matale, Monaragala, 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. The activities of the Project are implemented under four components namely Farmer Training and Capacity Building, Modern Agriculture Technology Demonstration Parks(ATDP), Production and Market Infrastructure Development and Analytical and Policy Advisory Support.
As per the Financing Agreement, the estimated total cost of the Project was US$ 88.69 million equivalents to Rs. 24,790.76 million and out of that US$ 63.16 million equivalent to Rs.17,080.15 million was agreed to be financed by the International Development Association. In addition, US$ 24.94 million equivalent to Rs. 7,538.05 million had been received from the European Commission Trust Fund to implement the activities in other districts such as Kandy, Badulla, Ampara, Kilinochchi and Vavunia. The balance amount of US$ 0.59 million equivalent to Rs 172.56 million is expected to be financed by the Government of Sri Lanka.
The Project had commenced its activities on 01 January 2017 and scheduled to be completed by 31 December 2021. However, the date of completion of the activities of the Project had been extended up to 31 December 2024.

1.3 Qualified Opinion

In my opinion, except for the effects of the matters described in the section 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 2024, statement of expenditure and its cash flows for the year then ended in accordance with 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

	Audit Issue	Amount Rs. Mn	Response of the Management	Auditor's Recommendations
(a)	The project had been made double payments to the construction company amounting to Rs.39.1 Mn under payment voucher No.192 and 208. Consequently, the value of development expenditure had been overstated by similar amount in the financial statements.	39.1	Admitted. The payments so made amounting to Rs.39,037,087,500 were immediately recovered from his other claims on 03rd April 2025.	Financial statements should be prepared accordingly.
(b)	As per the project design, a 25 percent contribution has to be collected from the farmers. However, Farmers' outstanding contribution balance of Rs.21 Mn had not been recorded in the financial statements as at 31 December 2024. As a result, receivable had been understated by similar amount.	21	The Management has not provided answer	Financial statements should be prepared accordingly.

2.2 Non Compliance with Laws, Rules and Regulations

	Reference to the Laws Rules and Regulations	Non Compliance/Audit Issue	Response of the Management	Auditor's Recommendations
(a)	Circular No PFD/RED/01/01/2020/01 dated 28 September 2020 issued by Public Finance Department	As per the circular, advance should be limited to Rs,100,000. But, the project had released 08 advances valued at Rs.1,487,725 exceeding Rs.100,000 amount in during the year under reviewed.	Admitted.	Circular instructions should be followed.
(b)	Circular No 01/2019 dated 15 March 2019 issued by the Department of Management Services.	Project Steering Committee (PSC) meeting should be held once in two month. However, only one PSC meetings had been held during the year under review.	Admitted.	Circular instructions should be followed.

(c)	Circular No CGIR/2019/03-1(Ins. & Cir) dated 09 July 2019 and Circular No CGIR/2021/02-02 dated 09 April 2021 issued by the Department of Inland Revenue	Project had not prepared and sent the VAT details to Department of Inland Revenue from the beginning of the project.	Admitted	Circular instructions should be followed.

3. Physical Performance

3.1 Contract Administration

Audit Issue	Response of the Management	Auditor's Recommendation
A contract was entered with a private company on 25 June 2023 for the construction of 75 hybrid seed production houses at a cost of Rs.399.198 Mn in the Kandy district. According the contract agreement, although 03 performance guarantees amounting to Rs.133,099,791 were required to be submitted, the performance guarantees had not been submitted by 13 August 2024. Although the construction of 75 farm houses was to be completed within 03 months, the construction of 35 houses had not been completed by August 2024. The project officials had not paid attention to the completion of the contract by giving a deadline for the construction of the farm houses.	The construction of 75 farmhouses has now been completed, and the farmers have commenced the seed Production Program.	Project activities should be completed within given contract period.

3.2 Underutilized Resources

	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	The project commenced in 2017 with a scheduled closing date of 31 December 2024. However, based on the financial data for the year 2024, from the funds financed by the World Bank ,it was observed that the project had been incurred development expenditure	Most of the Project activities were initiated at the beginning of the year 2020. The Covid situation which was followed by the socio-economic situation prevailed in the	Project planning, coordination and financial management should be done effective manner.

	amount of Rs.6,107,083,967 during the year and it was 36 percent of the total development expenditure financed by the World Bank. Furthermore, development expenditure amount of Rs.4,366,598,072 had been incurred from the fund financed by European Union for the year of 2024, it was 57 percent of the total development expenditure financed by the European Union. This indicates a disproportionately high utilization of funds during the final year of the project. The implementation activities were not carried out in a consistent and phased manner throughout the project period. The delayed execution and heavy spending in the closing year may reflect weaknesses in project planning, coordination and financial management, potentially affecting the achievement of intended project outcomes.	country also affected for the performance of the project.	
(b)	According to the information received by the audit, the project for the distribution of fertilizer to farmers for the years 2022 to 2024 was implemented based on a request from the World Bank and the EU. As per the project design, a 25 percent contribution was to be collected from the beneficiary farmers. Fertilizer worth Rs.442 Mn was procured during the period from 2022 to 2024, and accordingly, the project was expected to collect Rs.110 Mn as farmer contributions. However, the project sub-office handed over only Rs.89.81 Mn to the PMU by the end of the project on 31 December 2024.No information was available in the project records regarding the outstanding balance of Rs.21 million. This lack of accountability and incomplete recovery of contributions could result in financial loss to the project.	Comments had not been received.	Farmers' contribution should be collected properly.

(c)	Further, it was observed that the collected amount of Rs.89.81 Mn had not been transferred to the Treasury as of 31 December 2024.This amount was recorded under "Other Payables" in the financial statements and remained idle in the project's bank account for over one year.	From the total recovery of Rs.89,812,832.74, a sum of Rs.37,657,658.92 was transferred to the Revenue.	Collected contribution should be transferred to the Treasury.
(d)	Out of annual GOSL allocation of Rs.50 Mn under Vote No.118-02-03-053-2202-17, the Project had utilized only Rs.26.59 Mn and allocation of Rs.23.41 Mn representing 47 per cent had not been utilized during the year under review due to slow progress of the Project.	Agreed.	Funds should be utilized effectively and efficiently

3.3 Matters in Contentious Nature

Audit Issue	Response of the Management	Auditor's Recommendation
As at 31 December 2023, the project reported no outstanding creditor balance. However, creditor balances for construction and goods as at 31 December 2024 has been recorded amount of Rs.869 Mn and Rs.1,443 Mn respectively. This represents a significant increase and consider regarding the project's ability to settle these obligations, especially given that the project is scheduled to close on 31 December 2024. The ASMP project's financial capacity was not properly reviewed before starting these construction and goods contracts. As a result, entering into large contracts without confirmed funding could lead to payment issues for the contractors.	The Balance remained as of 30th April 2025 is Rs. 383 million for which action is being taken to obtain Cabinet Approval for additional funds.	Funds should be utilized effectively and efficiently.

3.4 System and Controls

	Audit Issue	Response of the Management	Auditor's Recommendation
(a)	It was observed that an amount of Rs. 62 Mn which was intended to be incurred from European Union (EU) funds has instead been utilized from World Bank funds by the Eastern and Northern Provincial Offices from the inception of the project up to the year 2023.This misallocation occurred due to the absence of separate accounting mechanisms to distinguish between EU and World Bank funding streams at the provincial level. Furthermore the issue was compounded by inadequate supervision and oversight by the Project Head Office (PMU) which failed to ensure proper fund management.	Admitted. Although clear Instructions had been issued, some Provincial Project Management Units, by mistake, had charged EU related expenditure under IDA Funds. Soon after this error was identified, action was taken to rectify the errors thorough transferring the relevant expenditure to EU Grant and refunding the Expenditure to IDA Loan Fund accordingly.	Funds should be utilized from relevant sources.
(b)	Monitoring Information System (MIS) valued at Rs.7,084,550 was implemented by the project in May 2021 which was four years and five months after the commencement of the project. Even the project had incurred higher cost for MIS system, the expected objectives has not been achived. Therefore, the cost incurred for MIS is idle.	This system has been actively utilized throughout the project implementation.	MIS should be utilized effectively for achieving desired objectives.
(c)	In accordance with best practices, all systems and related project information should be formally handed over to the respective Ministry upon the conclusion of the project period. However, as per the information made available to the audit, no formal plan has been established by the project for handing over the system and information to the Ministry prior to the expiration of the project's grace period.	The MIS is an Online Platform, and its hosting facility was discontinued upon completion of the physical activities of the project on 31st December 2024.	All systems and related project information should be formally handed over to the respective Ministry.