

Agriculture Sector Modernization Project – Part 01 - 2024

The audit of financial statements of Agriculture Sector Modernization Project – Part 01 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 Plantation 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. 20,151.61 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 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 2024, 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. Physical Performance

2.1 Physical and Financial Progress of the Activities of the Project

Component	As at 31 December 2024		Delay/ Audit Issue	Management Response	Auditor's Recommendation
	Expected physical performance Percentage	Performance achieved Percentage			

(a)	overall	100	86.7	<p>The project commenced on 17 January 2017 with an original duration of five years. However, due to various challenges, the timeline was extended twice, with the revised completion date set for 31 December 2024. Despite the extensions, the project had achieved only 86.7 percent overall physical progress by the end of the revised schedule. The continued delay may result in increased costs reduced stakeholder confidence and further impact on the timely realization of project benefits.</p>	Comments had not been received.	The activities of the project should be completed within planned time frame.
(b)	PDO-3 – Clients who have adopted an improved agriculture technology promoted by the project- (Productivity Indicator, Number)	70,500	<p>38,203</p> <p>(As a percentage 54 percent)</p>	<p>It was observed that targets of project objective had been achieved at a level of less than 59 percent as at 01 March 2025. This raises concerns regarding the effectiveness and efficiency of project execution.</p>	Agreed	The activities of the project should be completed within planned time frame.
(c)	PDO-4 - Clients who adopted an	36,000	<p>20,844</p> <p>(As a percentage</p>	<p>It was observed that targets of project objective</p>	Agreed	The activities of the project should be completed

improved agriculture technology promoted by the project-Female (Productivity Indicator, Number)	58 percent)	had been achieved at a level of less than 59 percent as at 01 March 2025. This raises concerns regarding the effectiveness and efficiency of project execution.	within planned time frame.
---	-------------	---	----------------------------

2.2 Observations made on site visits

Audit Issue	Response of the Management	Auditor's Recommendation
(a) An agreement had been reached with a private company to provide a matching grant of Rs.9.8 Mn to the company on 30 December 2020. The first matching grants tranche of Rs.4.55 Mn was made on 16 December 2020 and the second matching grant tranche of Rs.4.27 Mn was made, for a total of Rs.8.82 Mn as at 31 March 2022. The objectives presented for obtaining grants which was included establishing farmer clusters, providing facilities to farmers, purchasing the harvest of cluster farmers and adding export and domestic sales revenue to the national economy along with the expected production targets had not been achieved. Furthermore, the third matching grant tranche had not been received.	The company had failed to implement Several activities of the agreed budget due to the unexpected price increase of machinery and construction materials due to Covid 19 impact and the economic crisis during the implementation period. Also, there were some limitations on the forecasted market opportunities for the finished products, and hence the company couldn't meet the expected foreign revenue and the local sales as well.	The project should monitor achievements of targets as planned.
(b) An agreement was signed on 23 April 2019 to provide a grant of Rs.20 Mn to company which was established in the Kaduwela Divisional Secretariat area with the aim of manufacturing of Pharmaceutical supplements, packaging of food & beverages and beauty care products, to achieve the objectives of improving quality products and capturing the export market, improving existing products with new machines, focusing on value-added products and introducing new packaging methods for the foreign	The 2nd tranche of approved grant was released to company, as an advance payment, considering the achieved physical progress of the project activities.	The project should monitor achievements of target as planned.

market. The second matching grants tranche was also given by August 2019, but the company had not achieved the desired goals.

- | | | | |
|-----|--|--|--|
| (c) | <p>Matching grant of Rs.20Mn was reduced from Rs.20 Mn to Rs.15.54 Mn in the matching grant revision carried out on 08 April 2024. As the first and second matching grant tranches of Rs. 18 Mn had been paid as at 19 August 2019, the excess matching grant tranches to the company was Rs.2.45 Mn. The excess matching grant tranches of Rs.2.45 Mn had not been recovered as at 31 December 2024 and disciplinary action had not been taken against the responsible officers.</p> | <p>ASMP had taken actions by informing the company to refund the unsettled amount of disbursed 2nd tranche, before that was revealed/ reported by any other party and hence there is no reason to take any action against ASMP officials.</p> | <p>The overpaid amount should be recovered and disciplinary action should be taken against the responsible officers.</p> |
| (d) | <p>The company which is operating in the Ratnapura Divisional Secretariat area of the Ratnapura District had entered into an agreement on 19 December 2022 to receive a matching grant of Rs.15.54 Mn from the Project. By the end of 2024, the first and second matching grants tranche had been received, but the third matching grant tranche had not been received. Machines worth Rs. 3.585 Mn that were to be obtained from the first matching grant and machines worth Rs. 1.677 Mn that were to be purchased from the second matching grant had not been purchased by December 2024. Accordingly, it was observed that the project officers had not supervised the disbursement of grants.</p> | <p>After completion of purchasing all machinery, the third tranche was released for the company. Prior to this, the Matching Grant Manager (MGM) and Monitoring and Evaluation (M&E) Specialist visited the site before the release of the second tranche and the third tranche.</p> | <p>The projects disbursement of grants within relevant time and targets should be achieved within time period.</p> |
| (e) | <p>The company had entered into an agreement to obtain a grant of Rs.10.56 Mn under the Project Matching Grants by targeting the export market with the ultimate objective of establishing a cinnamon processing center in the Ayagama Divisional Secretariat area of the Ratnapura District and improving the harvesting process. By November 2019,</p> | <p>Company commenced cinnamon processing in 2019, following the receipt of the first and second tranches amounting to Rs.9.515 Mn. However, due to unexpected flooding, part of the machinery was submerged, leading to a temporary halt in production.</p> | <p>Action should be taken to frequently monitor the achievements of target as planned.</p> |

the company had received Rs.9.51 Mn as first and second matching grant tranches and by December 2024, the company had ceased operations. Accordingly, the company's desired objectives of improving the cinnamon harvesting process, introducing cinnamon products to the export market, developing it as a model project that would facilitate the production of 5000 kg of fresh cinnamon per day, developing the livelihood of cinnamon farmers around Ayagama and providing employment opportunities had not been achieved. Further, it was observed that the Company had not received the final matching grant tranche even after 5 years and that the Project had not properly evaluated the company's performance before and after entering into agreements with the company. Even though the loan obtained by the Government of Sri Lanka from the World Bank Fund on the basis of repayment of the loan and interest, it had not been able to provide the government with sufficient expected benefits.

The third tranche was issued and production has since restarted. Despite these efforts, the company could not achieve the originally anticipated outcomes due to prevailing economic conditions. Nevertheless, the company is optimistic about reaching its targets in the near future.

2.3 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 2024, it was observed that the project utilized only USD 43.73 Mn funds out of allocation of USD 48.62 Mn by the IDA Loan. As a percentage, it was 90 percent. Therefore, it had been observed the utilization of funds is ineffective when considering the rest of three months’ time period with balance funds.	According to the final account by 30th April 2025 utilized amount is USD 45.9 million and financial progress is 94 percent .	Loan fund should be utilized effectively.

- | | | | |
|-----|--|--|--|
| (b) | <p>It was observed that the project has utilized only Rs.1,250.31 Mn from allocation for the reimbursable foreign loan of Rs.1,600 Mn for the year under review. Therefore, allocation of Rs.349.69 Mn representing 22 percent of the total allocation had not been utilized by the project.</p> | <p>Utilization of matching grant totally depends on the performance of the proponent. Board of Directors decided to scaled down and restructuring some sub projects referring to under performance of those sub projects. Therefore, funds allocate for those sub projects were not utilized by the project.</p> | <p>Loan fund should be utilized effectively.</p> |
|-----|--|--|--|

2.4 Matters in Contentious Nature

Audit Issue	Response of the Management	Auditor's Recommendation
<p>(a) The project had implemented 1,449 projects with an approved matching grant value of Rs.9,811 Mn as of 31 December 2024.Of these, the number of projects awarded three matching grants tranches had been 1,253 and the value of matching grants awarded had been Rs.7,721 Mn. By December 2024, the number of projects to which were granted the first and second matching grants tranches had reached 61 and the value of the matching grants granted had reached Rs.660 Mn. It was observed that the projects worth Rs.660 Mn were non completed projects that have not achieved their targets. Legal action had not been taken by the ASM Project regarding those projects by the end of the year under review. There were 59 projects to which ASMP provided only the first matching grants tranche and the grant value provided was Rs.154.525 Mn. All the projects for which the first matching grants tranche was provided had failed. By 31 December 2024, matching grants amount of Rs.14.97 Mn had been recovered from 05 companies. Due to the death and bankruptcy of the owners of the companies that received matching grants, Rs.12.35 Mn provided to three companies had been abandoned.</p>	<p>There are 61 sub-projects out of a total of 1449 projects that have issues of not complying with the project agreement. Legal actions were started against those sub-projects on the grounds of breach and violation of the agreement. There are 1261 projects are functioning smoothly.</p>	<p>The activities of the project should be completed within planned time frame.</p>

- | | | |
|---|--|---|
| <p>(b) According to the available information a total of 1,380 projects had been completed as at 30 April 2025. According to comprising 154 large-scale projects, 311 small-scale projects and 914 cluster projects. It was observed that only 269 completion reports had been prepared by the Agriculture Sector Modernization Project as at 05 June 2025 in accordance with the requirements outlined in the project agreement. This reflects a significant shortfall in project documentation and raises serious concerns regarding compliance with reporting obligations, as well as the effectiveness of project monitoring and evaluation mechanisms.</p> | <p>The Implementation Completion and Results Report (ICR) has already been officially handed over to the World Bank, fulfilling the reporting obligation for the completed projects under the program.</p> | <p>The activities of the project should be completed within planned time frame.</p> |
|---|--|---|

2.5 Issues Related to Human Resources Management

Audit Issue	Response of the Management	Auditor's Recommendation
<p>It was observed that nineteen individuals were recruited as Project Implementation Assistants for a period of six months commencing from 01 July 2024, each with a proposed monthly remuneration of Rs.60,000. However, no formal approval or documented decision was available to justify the proposed payment structure. Furthermore, the agreements entered into with these individuals did not contain clearly defined provisions regarding leave entitlements. Additionally, there was no evidence to indicate that a transparent and competitive recruitment process such as public advertisement had been conducted prior to their selection. It was also noted that there were inadequate supervision and monitoring mechanisms in place to assess the actual work performed and to verify the attendance and level of engagement of the personnel recruited for these positions.</p>	<p>According to World Bank guidance and advice of the secretary to the line ministry during the mission, these 19 PIAs were recruited as consultants for a short-period assignment, and the procurement procedure applied to "World Bank Funded Projects" has been followed. Salary and leave are also decided as per the contract agreement.</p>	<p>Staff should be supervised and assigned tasks of the project.</p>