

## **Local Loans and Development Fund-2011**

### **1. Financial Statements**

#### **1.1 Qualified Opinion**

In my opinion, except for the effects of the matters described in paragraph 1.2 of this report, the financial statements give a true and fair view of the financial position of the Local Loans and Development Fund as at 31 December 2011 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

#### **1.2 Comments on Financial Statements**

##### **1.2.1 Accounting Standards**

Following non-compliances were observed.

- (a) The Loan repayment amounting to Rs: 34,521,003 which should be settled to the Treasury within one year period had not been shown under current liabilities in terms of SLAS 3.
- (b) Post-employment benefit obligation should be made using a Gratuity Formula Method in terms of SLAS 16. However Gratuity Liability had not been computed in accordance with above requirement.
- (c) The current tax liability had not been calculated in terms of paragraphs 5 and 46 of SLAS 14.

##### **1.2.2 Accounting Deficiencies**

Following observations are made.

- (a) Staff training expenditure of Local Loans and Development Fund (LLDF) amounting to Rs. 598,603 had been accounted as Fixed Assets considering as modernization expenses instead of being charged against revenue. Therefore fixed assets and the financial results (surplus) for the year 2011 had been overstated by the same amount.
- (b) A sum of Rs. 2,847,449 paid for the purchase of 15 laptopcomputers and other computer accessories had been capitalized as modernization expenses instead of being accounted for as computer equipment. Therefore, the modernization expenses had been overstated by the same amount.
- (c) A sum of Rs. 682,690 spent for partitioning work of the building taken on rent in which the Institution is functioning, had been capitalized instead of being charged against income.

##### **1.2.3 Unreconciled Balances**

As per financial statements the balance of interest receivable from Local Authorities (LGIIP) as at 31 December 2011 was Rs: 76,131,812 and as per schedule attached to the financial statements it was shown as Rs: 83,857,352. Hence a difference of Rs; 7,725,540 was observed.

**1.2.4 Accounts Receivable and Payable**

The following observations are made.

- (a) Loan balances aggregating Rs: 535,502,937 which was given by the LLDF, to Local Authorities had been shown under non-current assets as debtors. Details are as follows.

Local Authority Outstanding Loan balances as at 31 December 2011

	Rs.
Municipal Councils	99,229,915
Urban Councils	92,845,901
Pradeshiya Sabhas	<u>343,427,121</u>
Total	<u>535,502,937</u>

Adequate provision for bad and doubtful debts had not been made for un-recoverable loan balances appearing in the financial statements as balances aggregating to Rs.22, 389,336 was outstanding for a long period of time.

- (b) It was observed that loans receivable amounting to Rs.5,826,916 were due from 22 Pradeshiya Sabhas for over 30 years as at 31 December 2011.
- (c) Out of the total LLDF debtors balance of Rs. 567, 892,273 which was shown in the Balance Sheet as at 31 December 2011, only a sum of Rs. 207,250,165 or 36.49% had been confirmed by the respective customers even by 30 June 2012.
- (d) Out of the total debtor balances of Urban Development Low Income Housing Project aggregating Rs.1,877,436,728 which was shown in the Balance Sheet as at 31 December 2011, only a sum of Rs. 552, 657,018 or 29.43% had been confirmed by the respective customers even by 30 June 2012.

**1.2.5 Lack of Documentary Evidence for Audit**

Following evidences were not made available for audit.

<u>Item</u>	<u>Value</u> Rs.	<u>Evidence not available</u>
(i) Non-performing loan interest		}
Local Loan and Development Fund	16,534,087.50	
Perennial Crop Development Project	22,733,319.45	
Urban Development and Low Income Housing Project	367,966,712.54	
(ii) Interest receivable-Non-current		
UDLIHP	20,745,940.86	
PCDP	8,461,973.78	Confirmations and Age analysis

### 1.2.6 Non-compliance with Laws, Rules, Regulations, and Management Decisions

Instances of non-compliance observed in audit are given below.

**Reference to Laws, Rules, Regulation etc.**

**Non-Compliance**

(a) Treasury Circular No:

IAS/ 2002/02 of 28  
November 2002

(i) Paragraph 2

A separate Register of Fixed Assets in terms of the Circular had not been maintained for the computers valued at Rs: 5,320,454 owned by the Fund.

(ii) Paragraph 4

Even though the staff officers in charge of computers should maintain a file on the computer data base on the information appearing in the Register of Computer Assets, it had not been so maintained.

(b) Financial Regulations

FR 507(2)

The existence of each item of assets should be verified on 31 December and note the condition of the assets. A statement of fixed assets as at the end of the year under review prepared accordingly was not furnished to the Auditor General along with the annual accounts.

### 1.2.7 Unauthorized Transactions

Following observations are made.

(a) As per the recommendation of the Board of Commissioners of Local Government Infrastructure Improvement Project, capitalization of interest up to the completion date of the projects on the amounts disbursed from time to time had been made. Due to non-entering of a condition for capitalization of interest into loan agreement, significant variance was observed between loan amount shown in agreement and loan amount shown in the accounts. Hence interest of Rs.54,914,558 had been capitalized as at 31 December 2011 without the consent of the borrower.

(b) According to the Loan agreement (LGIP), delay in payment of interest in more than three months an additional interest of 2% on the delayed amount for the duration of delay should be paid. However, 11% of additional interest had been charged on delay in payment of interest, in contrary to the conditions in the Loan agreement.

**2. Financial Review**

**2.1 Financial Results**

According to the financial statements presented, the operations of the Fund for the year ended 31 December 2011 had resulted in a deficit of Rs. 49,075,907 after tax as compared with the corresponding deficit Rs. 14,987,619 after tax for the preceding year, thus indicating an increase of Rs. 34,088,288 in the deficit for the year under review. The deficit of Rs. 42,576,812 , Rs. 17,792,989 and Rs. 834,819 relating to the Local Government Infrastructure Development Project, Urban Development Low Income Housing Project and Perennial Crop Development Project respectively for the year 2011 had also been included in the above deficit.

The following table gives a summary of financial results for the year under review and the preceding year.

	<u>Year ended 31 December</u>		<u>Variation</u> %
	<u>2011</u> Rs.	<u>2010</u> Rs.	
Interest Income on Loans Granted	246,790,845	227,053,363	9
Interest expenses on Treasury Loans	(164,019,863)	(157,702,050)	4
Operating Surplus	82,770,982	69,351,313	19
Investment Income	6,297,567	5,934,506	6
Other Income	2,371,573	166,357	1326
Administrative Expenses	(15,542,869)	(14,297,694)	9
Gross Surplus	75,897,253	61,154,481	24
Net Grant amortization	(121,674,545)	(65,868,283)	85
Income tax paid	(1,298,615)	(4,623,817)	-72
Overall deficit for the year	(47,075,907)	(9,337,619)	404
Provision for Income Tax	( 2,000,000)	(5,650,000)	-65
Deficit after provision for Tax	(49,075,907)	(14,987,619)	227

**2.2 Analytical Financial Review**

The financial results of the year under review as compared with last preceding four years are given below.

	<u>2011</u> Rs. (000)	<u>2010</u> Rs. (000)	<u>2009</u> Rs. (000)	<u>2008</u> Rs. (000)	<u>2007</u> Rs. (000)
Total Income	255,460	233,776	191,869	164,204	167,355
Total Expenditure	(179,563)	(172,622)	(169,830)	( 158,169)	(121,378)
Gross Surplus	75,897	61,154	22,039	6,035	45,977
Payment to Consolidated Fund	-	-	(5,000)	(3,000)	(3,000)
Provision for Bad Debts	-	-	-	(12,000)	(26,542)

Net Grant Amortization	(121,674)	(65,868)	(30,985)	-	-
Income Tax paid	(1,299)	(4,624)	(11,279)	-	
Net Surplus/ (deficit)	(47,076)	(9,338)	(25,225)	(8,965)	(16,434)
Provision for Income Tax	( 2,000)	(5,650)	(6,500)	(10,127)	(500)
Surplus/Deficit after provision for Tax	(49,076)	(14,988)	(31,725)	(19,092)	15,934

The following observations are made in this regard.

- (a) The total income had increased from Rs. 167.3 million to Rs: 255.4 million 52.65 per cent during the period of 2007- 2011 and total expenses had increased from Rs.121.3 million to Rs 179.5 million or 47.98 per cent during the same period..
- (b) The net grant amortization of Local Government Infrastructure Improvement Project (LGIIP) had increased from Rs. 30.98 million to Rs. 121.67 million or 292.74 per cent during the period of 2009 to 2011.
- (c) The Deficit after provision for tax had been increased from Rs. 19.09 million to Rs. 49.07 million or 157.04 per cent during the period of 2008 to 2011.

### **3 Operating Review**

#### **3.1 Performance**

The main function of this Fund is to provide loans under the concessionary interest rates to the revenue earning projects and for the improvements of infrastructure facilities of non-revenue earning nature projects of Local Authorities. In addition, the management of the recovery of loan installments and interest of the Perennial Crops Development Project, the Urban Development and Low Income Housing Project and Local Government Infrastructure Improvement Project financed by the Asian Development Bank are also functions of the Fund.

##### **3.1.1 Loan Administration**

###### **(a) Performance of Local Government Infrastructure Improvement Project (LGIIP)**

Following observations are made.

- i. The LL&DF has signed a Project Agreement with ADB for implementation of Loan No: 2201 SRI (SF) and had taken over, full responsibility of the implementation and monitoring of the sub projects. Project period will be terminated in next year but out of approved project cost of Rs. 5,955 million, only Rs. 3,382 million or 56.79 per cent had been disbursed up to 31 December 2011.
- ii. Under this project, Local Authorities are entitled to receive a grant and a loan component which varies depending on the category of the Local Authorities (LA). LA's were given Loans and grants aggregating Rs. 1,343,983,387 and Rs. 2,079,781,901 respectively as at 31 December 2011. However the ADB provided

Rs. 2,589,283,200 as a loan to LL&DF. It is repayable within 32 Years with a grace period of 8 years at an interest rate of 1% per annum during the grace period and 1.5% per annum thereafter. An interest rate of 9% is charged by the LLDF on the loan given to Local Authorities. Only a sum of Rs. 36,748,199 had been received, out of total interest receivable balance amounting to Rs. 108,738,150. According to the age analysis presented to audit, out of outstanding loan installments amounting to Rs. 45,678,980, a sum of Rs: 13,811,099 was outstanding for more than 90 days.

- iii Net grant amortization of Rs. 121,674,545 had been charged to the income statement during the year under review. While the majority of grant had to be managed out of the interest margin by the Fund. Therefore Fund management is very crucial for LL&DF's future.
- iv According to the Loan Agreement No.2201 SRI (SF) dated 19 January 2006 entered into between the Democratic Socialist Republic of Sri Lanka and the Asian Development Bank, the implementation of the Component " B " of the Local Authorities Infrastructure Development Project had been assigned to the Local Loans and Development Fund. Under this, a sum of U S \$ 42.6 million (Rs. 4,260 million) had been allocated to the Local Loans and Development Fund for the improvement of infrastructure of Local Authorities. Although it had been estimated to release Rs. 2,181 million to the project during the year under review, only a sum of Rs. 1,321 million had been released.

**(b) Performance of Urban Development Low Income Housing Project (UDLIHP)**

The Local Loan and Development Fund (LL&DF) had undertaken to recover the loan amounting to Rs. 2,270,125,714. granted by the Urban Development and Low Income Housing Project (UDLIHP), as a recovery agency to the Treasury. These loans are to be repaid to the Treasury within 25 years by equal installments at the rate of 5.25% while recovery is made from Local authorities by 64 and 40 quarterly installments at 8% and 10% interest rate. Out of 106 loans aggregating Rs.1,877,436,727 granted as at 31 December 2011, no any single capital installment had been paid by 19 Loans aggregating Rs.469,972,626 as at 31 December 2011. Interest receivable amounting to Rs. 64,893,552 from 31 loans were categorized as interest in suspense during the year under review. Total accumulated interest in suspense amounted to Rs. 367,966,712 for the period of 2005 to 2011. Effective action had not been taken to recover these outstanding balances and adequate provision also had not been made in the accounts.

**(c) Perennial Crops Development Project (PCDP)**

Following observations are made.

- (i) Sums of Rs. 72,001,574 and Rs. 31,195,292 shown in the financial statements represented capital and interest receivable on loans granted to Local Authorities respectively by Perennial Crops Development Project (PCDP) as at 31 December

2011. No any installment had been paid at all by the Dambulla Pradeshiya Sabha on the Loan of Rs.12 million granted in 1995.

- (ii) Out of the initial loan balance amounting to Rs. 60,922,475 released to Kandy Municipal Council in 1995,a sum of Rs.59,781,574 had remained unsettled as at 31 December 2011.

**(d) Granting of Loans(LLDF)**

The Fund had been allocated a sum of Rs.175 million for providing loans to various projects during the year under review and loans amounting to Rs. 105.5 million had been granted during the year 2011. Matters observed in this connection are given below.

- (i) A Sum of Rs.75 million had been granted for the purchase of Machinery and Equipment which had been estimated at a cost of Rs.35 million for 6 projects. Therefore a sum of Rs. 40 million had been over disbursed and only 4 projects had been completed.
- (ii) Although a sum of Rs. 20 million had been allocated for providing loans to construct an office building, libraries and memorial halls under 5 projects in the year under review, a sum of Rs. 92,000 or 0.46 per cent had been provided and only one project was completed.
- (iii) A sum of Rs. 25 million had been allocated for 3 projects to construct of a weekly fair and economic centers. out of it a sum of Rs.9.57 million had been disbursed and only 4 projects were completed during the year under review.
- (iv) A sum of Rs: 25 million had been allocated for 5 projects to construct of Crematoriums and out of it a sum of Rs. 14.33 million had been disbursed. However only 4 projects were completed during the year under review.
- (v) A sum of Rs: 15 million had been allocated for 2 projects, to develop roads.Out of it a sum of Rs: 6.7 million had been disbursed. However only one project had been completed during the year under review.
- (vi) Although Rs.5.5 million had been allocated for 3 projects to construct public markets, to implement a solid waste management project, 5 Water Supply Schemes, procure 50 motor cycles and to implement other Revenue earning Projects, no any single loan had been granted for these projects during the year under review.

**(e) Recovery of Outstanding Loan Installments (LLDF)**

Out of loan installments due from Local Authorities as at 01 January 2011 amounting to Rs. 26.5 million, only a sum of Rs.13.58 million had been recovered during the year under review. Details are as follows.

Local Authorities	Outstanding Installments as at 01 January 2011	Recoveries made during the year 2011	percentage of Recovery
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	Rs.	Rs.	%
Municipal Councils	1,706,882	1,706,882	100
Urban Councils	11,736,158	2,162,393	18.42
Pradeshiya Sabhas	13,041,864	9,348,112	71.67
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Total	26,484,904	13,217,387	50.0
	=====	=====	=====

The following observations are made in this regard.

The recovery of loan installments outstanding from Urban Councils as at 01 January 2011 had been at a low level of 18.42 per cent, the percentage of recoveries from the Pradeshiya Sabhas had been 71.67 per cent. Thus indicating the overall loan recovery percentage was 50 per cent.

- (i) Out of loans amounting to Rs.7,850,000 and Rs.2,012,000 granted to the Urban Councils of Panadura and Valvettithurai respectively sums of Rs.4,850,000 and Rs.1,888,755 respectively had been outstanding as at 31 December 2011. .
- (ii) Out of the Loan amounting to Rs. 1,150,000 granted to the Pradeshiya Sabha-Damana in the year 2003 for the development of Hingurana weekly fair, only an installment of Rs. 40,537 had been recovered. No installments had been recovered there after.
- (iii) Out of the Loan amounting to Rs.855,000 granted to the Pradeshiya Sabha , Karachi in the year 1983, an installment amounting to Rs.11,285 and an interest amounting to Rs.486,677 only had been recovered up to the year 1999.
- (iv) Out of the loan amounting to Rs.940, 000 granted to the Pradeshiya Sabha, Weligama in the year 1982, installments amounting to Rs.376, 000 only had been recovered.
- (v) Out of the loan amounting to Rs.1,791,500 granted to the Pradeshiya Sabha, Medagama in the years 1986 and 1987, installments amounting to Rs. 331,927only had been recovered.
- (vi) No any single installment had been recovered in respect of loans amounting to Rs.469,972,626 and Rs.12,000,000 granted by the Urban Development and Low Income Housing Project and the Perennial Crops Development Project respectively from Local Authorities.



(f) **Recovery of Outstanding Loan Interest (LLDF)**

Out of the loan interest amounting to Rs. 18.47 million outstanding as at 01 January 2011, the recoveries made in the year under review were as follows.

Local Authorities	Outstanding Interest as at 01 January 2011 Rs.	Recoveries during the year 2011 Rs.	percentage of Recovery %
Municipal Councils	643,806	643,806	100.00
Urban Councils	11,024,597	954,496	8.65
Pradeshiya Sabhas	6,806,371	2,699,683	39.66
<b>Total</b>	<b>18,474,774</b>	<b>4,297,985</b>	<b>23.26</b>

The following observations are made in this connection.

- (i) The recovery position during the year under review in respect of the Urban Councils and Pradeshiya Sabhas had been at a low level of 8.65 per cent and 39.66 per cent respectively. The loan interest recoveries from the Municipal Councils had been 100 per cent. Thus indicating the overall loan interest recovery percentage was to only 23.26 per cent.
- (ii) Out of the loan interest recoverable from the Local Authorities for the year 2011 amounting to Rs: 50,124,087, a sum of Rs: 44,705,330 or 89.2 per cent had been recovered as at 31 December 2011.
- (iii) The outstanding loan interest recovered during the year 2011 amounted to Rs.4.2 million out of the total outstanding interest of Rs.18.4 million as at 01 January 2011.

An age analysis of outstanding loan Interest as at 31 December 2011 is shown below.

Period	Amount of Outstanding Loan Interest Rs.
Over 5 years	10,089,324
Over 1 year and less than 5 years	4,117,899
Less than 1 year	<u>5,408,757</u>
<b>Total</b>	<b>19,615,980</b>

- (iv) The amounts of loan granted to the Urban councils of Panadura, Ampara and Ambalangoda were Rs. 7,850,000 Rs. 7,270,000 and Rs. 3,360,000 respectively.

The loan interest due up to the year 2011 amounted to Rs. 6,356,000, Rs. 1,323,860 and Rs. 2,378,984 respectively.

- (v) The details of outstanding loan interest on the loans granted to Pradeshieya Sabhas are shown below.

<u>Paradeshieya Sabha</u>	<u>Amount of Loan Granted</u>	<u>Interest due as at 31 December 2011</u>	<u>Period of outstanding</u>
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	Rs.	Rs.	Rs.
Hakmana	3,000,000	1,043,861	2005-2011
Beruwala	9,900,000	119,133	2011
Beliatta	13,000,000	235,941	2011
Damana	1,950,000	298,026	2006-2011
Embilipitiya	10,122,900	430,849	2008-2011
Madagama	1,791,500	2,396,770	Over 5 years

**(g) Progress of Interest Recovery**

Total loan interests outstanding as at 01 January 2011 and the recoveries made in the year under review were as follows.

- (i) Local Loans and Development Fund (LLDF)

<u>Loan Category</u>	<u>Total interest receivable as at 01 January 2011</u>	<u>interest received during 2011</u>	<u>Receivable as at 31 December 2011</u>	<u>Percentage Of interest received</u>
	Rs.	Rs.	Rs.	%
Non-Performing Loans- LLDF	16,534,087	Nil	16,534,087	-
Loan Interest receivables (non-current)	18,516,750	4,199,398	14,317,351	22.68
Loan Interest receivables (current)	<u>49,997,708</u>	<u>44,588,951</u>	<u>5,408,757</u>	89.18
Total	<u>85,048,545</u>	<u>48,788,349</u>	<u>36,260,195</u>	57.37

(ii) Urban Development Low Income Housing Project(UDLIHP)

<u>Loan Category</u>		<u>Total interest receivable</u>	<u>Interest received</u>	<u>Receivable</u>	<u>Percentage Of interest received</u>
		<u>01 January 2011</u>	<u>2011</u>	<u>31December 2011</u>	<u>received</u>
		<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>	<u>%</u>
Non-Performing UDLIHP	Loans-	372,251,500	4,284,787	367,966,712	1.15
Loan Interest receivables (non-current)		22,542,923	1,796,982	20,745,941	7.97
Loan Interest receivables (current)		<u>91,458,641</u>	<u>76,145,884</u>	<u>15,312,757</u>	83.26
Total		<u>486,253,064</u>	<u>82,227,653</u>	<u>404,025,410</u>	16.91

(iii) Perennial Crops Development Project (PCDP)

<u>Loan Category</u>		<u>Total interest receivable</u>	<u>Interest received</u>	<u>Receivable</u>	<u>Percentage Of interest received</u>
		<u>01 January 2011</u>	<u>2011</u>	<u>31December 2011</u>	<u>interest received</u>
		<u>Rs.</u>	<u>Rs.</u>	<u>Rs.</u>	<u>%</u>
Non-Performing PCDP	Loans-	24,928,137.93	2,194,818.48	22,733,319.45	8.80
Interest receivables from PCDP(non-current)		8,461,973.78	0	8,461,973.78	0
Interest receivables from PCDP (current)		<u>5,463,842.46</u>	<u>5,457,242.46</u>	<u>6,600.00</u>	99.88
Total		<u>38,853,954.17</u>	<u>7,652,060.94</u>	<u>31,201,893.23</u>	19.69

Long dues of the loan capital or interest are classified as non-performing and only interest is accrued in an interest suspense account. Actual value of capital arrears had not been disclosed in the accounts. Even though lot of interests suspense were written off and loans had been restructured in the past years, proper action had not been taken to recover the arrears of loans during the year under review. Out of total interest in suspense receivable amounting to Rs. 413,713,725 as at 01 January 2011, a sum of Rs. 6,479,605 or 1.57 per cent only had been received during the year under review.

**(h) Total Loans, Non-Performing Loans and NPL Ratios**

According to the information made available total loans outstanding , non-performing loans and NPL Ratio for the year ended 31 December 2011 and preceding two years are given below.

Institute/Project	2011			2010			2009		
	<u>Capital</u>	<u>Non</u>	<u>NPL</u>	<u>Capital</u>	<u>Non</u>	<u>NPL</u>	<u>Capital</u>	<u>Non</u>	<u>NPL</u>
	<u>Outstanding</u>	<u>Performing</u>		<u>Outstanding</u>	<u>Performing</u>		<u>Outstanding</u>	<u>Performing</u>	
Rs.Mn	Loans Rs.Mn	%	Rs.Mn	Loans Rs.Mn	%	Rs.Mn	Loans Rs.Mn	%	
LL&DF	567.89	14.24	2.5	594.79	14.24	2.4	587.80	14.24	2.4
UDLIHP	1,877.44	878.06	46.7	1,950.57	882.89	45.2	2,013.19	884.46	43.9
PCDP	72.00	71.78	99.6	73.15	72.92	99.7	73.28	72.92	99.
Total	2,517.33	964.08	38.3	2,618.51	970.05	37.0	2,674.27	971.62	36.3

It was observed that the Non-performing loans percentage had increased during the period of 2009 – 2011 with regard to all three loan schemes.

**3.2 Management Inefficiencies**

Loan installments and interest recoveries of the revolving fund made in the year 2011 were as follows.

	Rs.
Total installments and interest recoveries	418,212,437
Less: Total capital and interest paid to Treasury	<u>(199,115,262)</u>
Balance of funds	219,097,175
Loan released	<u>(105,707,000)</u>
Excess funds	113,390,175
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The following observations are made in this regard.

- (a) The LL&DF Vision is to be the leader of financial institution for local level infrastructure financing. Therefore the LL&DF has to provide long term financing to Local Authorities for basic infrastructure services. LL&DF has earned total capital and interest income of Rs.418.2 million and paid back to Treasury amounting to Rs.199.1 million. Out of capital and interest received, Rs.105.7 million only had been granted to Local Authorities as loan during the year under review.
- (b) Although a sum of Rs. 847,000 had been paid to a private Company to develop a Computer Software for the use of Local Loans and Development Fund, it was observed that the software had not been properly functioned even by 21 May 2012, the date of audit examination.
- (c) Loan granted to Kandy MC amounting to Rs. 30 million during the year under review without considering the previous arrears of loan installments of Rs: 105.29 million from PCDP and capital outstanding of Rs. 355.15 million from UDLIHP.

### **3.3 Operating Inefficiencies**

Following observations are made.

#### **(a) LGIP Loans**

According to the test checks carried out by the audit, following major weaknesses were observed in the management of LGIP loans.

The loan amounting to Rs: 37,514,097 had been granted to Gampaha MC for the construction of Storm Water Project in the year 2008 and expiration of the grace period was on 31 October 2010. According to the agreement, immediately after expiration of the grace period, the loan installments have to be recovered. Although the total installment and interest in arrears was Rs: 3,855,237, proper action had not been taken to recover the outstanding loans up to 30 June 2012.

#### **(b) LLDF Loans**

According to the test checks carried out by the audit, following major weaknesses were observed in the management of LLDF loans.

(i) The loan amounting to Rs. 7,850,000 had been granted to the Panadura UC for the construction of shopping complex. Adequate security had not been obtained when granting the loans to the UC. Discussion of the management had been indicated the progress of project is stagnated. The loan installment had been released to the UC in three times even though the Commissioner of Local Government of the Western Province also indicated that this loan had been granted without proper approvals. The UC had obtained loans from People's Bank aggregating Rs.20 million for the construction of the same shopping complex by pledging these properties as security in the year 1995.

(ii) The loan of Rs.3.5 million had been granted for the purchase of a Escalator machine to the Hikkaduwa UC in the year 2005, without considering the arrears of previous loans of Rs.18, 214,587. No any loan installment had been paid after March 2009. Another loan had been granted for the construction of shopping complex amounting to Rs. 4.6 million to Hikkaduwa UC during the period of 2007 to 2009, without considering the previous loan arrears.

#### **(c) UDLIHP Loans**

According to the test checks carried out by the audit the following major weaknesses were observed in the management of UDLIHP loans.

##### **(i) Seethawakapura PS - Construction of Bus stand and Supermarket Complex. (UDLIHP)**

A loan amounting to Rs.146,752,738 had been granted to Seethawakapura PS for the construction of Bus stand and Supermarket Complex. This loan would be recovered from 48 installments of Rs. 3,668,818 from third quarter of 2005. According to the records, the loan balance as at 31 December 2011 was Rs. 146,006,623 and arrears of interest was Rs.60,248,441. Adequate securities had not been obtained when granting this loan and the credit worthiness had also not been considered when granting the loan.

(ii) Badulla MC – Construction of Welekade Market (UDLIHP)

A sum of Rs. 60,191,794.57 had been granted for construction of the Welekade market in Badulla MC. The Project Director had been requested from LLDF to recover this loan from 40 installments. However estimate, plan and work done status report had not been furnished to the audit.

The outstanding loan balance as at 31 December 2011 was Rs. 33,564,401. The recovery position had not been evaluated when granting the loan and adequate security had not been obtained. It was observed that due to construction defects, the MC was reluctant to repay the loan.

(iii) Badulla MC (UDLIHP)- storm water Drainage net work in Badulla town area.

A loan amounting, Rs. 21,778,551 had been granted and should be recovered by 72 installments. However total arrears as at 30 August 2011 was Rs. 10,572,703. Effective action had not been taken to recover the outstanding loan.

The loans had been granted to Badulla MC aggregating Rs. 103,059,368 for 7 projects during the period of 2004-2005. However repayment had not been made from the year 2007. Total outstanding loan as at 31 December 2011 was Rs. 95,682,184 and interest outstanding was Rs. 56,557,625.

(iv) Rathnapura MC–Road improvement project (UDLIHF)

A loan amounting to Rs.12, 656,450 had been granted and should be recovered in 64 installments since 2005. However the road had been destroyed due to construction defects. The MC had rejected the repayment of the loan and total loan outstanding as at 31 December 2011 was Rs. 8,014,764.

(v) Hikkaduwa UC- Subproject No. 5521- Improvement of storm water Drainage in (UDLIHP)

A loan amounting to Rs.16, 540,616 had been granted to the improvement of storm water Drainage in Hikkaduwa. The arrears of capital was Rs.1, 630,766 and arrears of interest was Rs.2,973,901 as at 30 August 2011. After three years from the beginning of the loan granted, repayment of loan had been stopped and proper action had not been taken by the LL&DF to recover the loan.

(vi) Ambalangoda UC -storm water Drainage Improvement project (UDLIHP)

A loan of Rs.12,142,439 had been granted to the Ambalangoda UC to construct of storm water Drainage Improvement project in the year 2005. However arrears of capital portion of this loan was Rs. 928,436 and arrears of interest was Rs 5,541,684 as at 31 December 2011. However the project had not been completed and also it had not been transferred to the UC. The installment in arrears was Rs.1,774,165. Proper action had not been taken to recover the loan.

(vii) Balangoda UC- Construction of “Bus park and Town” ( UDLIHP)

Out of the total loan granted amounting to Rs. 111,209,828 the outstanding balance of loan as at 31 December 2011 was Rs.58,135,245. According to the records, major construction

weaknesses were observed in the bus stand and shopping complex and electric item valued at Rs.20 million had been stolen. However the land and building had not been transferred to the UC. The loan had been granted without assessing the credit worthiness and had not been obtained adequate securities.

### **3.4 Un-economic Transactions**

Under The Asian Development Bank Loan No. 899 SRI (SF) loans had been given to Local Authorities by Perennial Crop Development Project. LLDF should recover and pay back this loan and interest to Treasury at a rate of 10% as the Recovery Agent. But the loan granted amounting to Rs: 60,922,475 to Kandy MC, had been repaid at a rate of 9% .Thus LLDF had sustained a loss of 1% per annum.

### **3.5 Human Resource Management**

According to the information made available, the approved cadre, the actual cadre and vacancies existed as at the end of the year under review is given below.

<u>Category of Staff</u>	<u>Approved Cadre</u>	<u>Actual Cadre</u>	<u>Vacant cadre</u>
Senior Manager	1	1	-
Managers	2	-	2
Junior Managers	2	1	1
Associated Officers	25	16	9
Management Assistants	8	5	3
<u>Non-Technical</u>			
Primary level Skilled	2	1	1
Primary level Unskilled	<u>2</u>	<u>1</u>	<u>1</u>
Total	<u>42</u>	<u>25</u>	<u>17</u>

The following observations are made in this regard.

- (a) It was observed that 17 vacancies were existed in the year 2011 against the approved cadre. However two vacancies in managerial level had been filled in year 2012.
- (b) Actions had not been taken to fill the other vacancies.
- (c) Even though certain targets had been set out regarding the Human Resource Management Development, in the Corporate plan for the period 2011-2013 and Action plan for the year 2011 , those targets had not been achieved.

### **3.6 Gratuity Fund**

A Gratuity Fund had not been established by the Fund up to 31<sup>st</sup> October 2012.

#### **4. Accountability and Good Governance**

##### **4.1 Internal Audit**

Accounting Officer of the LLDF should establish an Internal Audit unit for the purpose of the discharge of their duties and responsibilities. If not, internal audit unit attached to the Ministry concerned, may extend the scope of the work of such unit to cover the work performed by the Fund. Internal Auditor of the line Ministry had been appointed as Internal Auditor of the Fund and an audit programme relating to financial matters were prepared but no single audit had been carried out during the year under review.

##### **4.2 Budgetary Control**

Significant variances were observed when compared the budgeted income and expenditure with the actual income and expenditure of LLDF for the year 2011 and budgets had not been prepared and presented to audit for the PCDP and LGIIP projects during the year under review. Thus indicating that the budget had not been made use of as an effective instrument of good governance.

#### **5. Systems and Controls**

Deficiencies observed in systems and controls during the course of audit were brought to the notice of the Fund from time to time. Special attention is needed in respect of the following areas of control.

- (i) Recovery of outstanding loans and interest
- (ii) Loan disbursements
- (iii) Accounting
- (iv) Information system