Local Loans and Development Fund – 2015

The audit of financial statements of the Local Loans and Development Fund for the year ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information 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 Section 13(1) of the Finance Act, No.38 of 1971. My comments and observations which I consider should be published with the annual report of the Fund in terms of Section 14 (2) (c) of the Finance Act, appear in this report. A detailed Report in terms of Section 13 (7) (a) of the Finance Act, was furnished to the Chairman of the Fund on 24 April 2018.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgements, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund's preparation and fair presentation of the financial statements 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 the Fund's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and the extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Adverse Opinion

Had the matters described in paragraph 2.2 of this report been adjusted, many elements in the accompanying financial statements would have been materially affected.

2 Financial Statements

2.1 Adverse Opinion

In my opinion, because of the significance of the matters described in paragraph 2.2 of this report, the financial statements do not give a true and fair view of the financial position of the Local Loan and Development Fund as at 31 December 2015 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Presentation of Financial Statements

In terms of Section 6.5.1 of the Public Enterprises Circular No.PED/12 dated 02 June 2003, the financial statements should be furnished to the Auditor General within 60 days from the close of year of accounts. Nevertheless, the financial statements for the year 2015 had been furnished on 28 February 2017, after a delay of one year.

Even though the financial statements for the year under review had been signed by the Chairman, Executive Officer and a member of the Director Board, the assurance of management's responsibly had not been included in pursuance of Public Enterprises Circular No.PED/45 dated 02 October 2007 .

2.2.2 Maintenance of Accounting Records

The Funds had not properly maintained its accounting records. Further, all the transaction required to be brought to account had not been included in the ledger accounts while ledger accounts had not been balanced at the end of the year. Therefore, it was not possible to establish the accuracy of the balances included in the financial statements through the ledger accounts in audit and the Statement of Financial Position as at 31 December of the year under review had been balanced by including a sum of Rs.22,063,699 as doubtful receipts under the current liabilities.

2.2.3 Sri Lanka Accounting Standards

The following observations are made.

(a) Sri Lanka Accounting Standard 01

(i) A statement of changes in equity had not been furnished in terms of Paragraph 10 of the Standard.

(ii) As operations of the fund similar to the operations of a financial institution, assets/ liabilities should be classified in order of liquidity as stated in terms of the paragraph 60. Nevertheless, attention had not been drawn thereon in the preparation of financial statements.

(iii) In terms of Paragraph 61 of the Standard, the items expected to be recovered or settled should be disclosed in the financial statements as the period not more than 12 months and the period of more than 12 months after the reporting period, whereas action had not been taken according to the standard in respect of staff debtors, other debtors and the loans obtained from the Treasury.

(iv) In terms of Paragraph 117 (b) of the Standard, a summary of significant accounting policies used for understanding the financial statements should be disclosed. Nevertheless, accounting policies relating to the financial assets and taxation had not been disclosed and comprehensive details had not been made available by the accounting policy disclosed for the Property, Plant and Equipment.

(b) Sri Lanka Accounting Standard 12

Major components of tax expenses had not been separately recognized and disclosed in terms of Paragraph 79 of the Standard.

(c) Sri Lanka Accounting Standard 16

(i) In terms of Paragraph 55 of the Standard, although depreciation of an asset begins when it is available for use, without being complied with the above matter, it had been stated that the assets would not be depreciated in the year of purchase.

(ii) Although useful lives or depreciation rates used for all the classes of assets should be disclosed in terms of Sections 73 (c) of the Standard, depreciation method, depreciation rates or useful lives of the computer, software and modernization assets had not been disclosed in the financial statements.

(d) Sri Lanka Accounting Standard 19

In terms of Paragraphs 140(a), 141 (a), (b), (c) and (d) of the Standard, although the net benefit liability (asset), current service cost, interest income or expenditure, re-measurement of net benefit liability (asset) and the past service cost should be disclosed as a reconciliation from the opening balance to the closing balance, action had not been taken accordingly.

2.2.4 Accounting Policies

The following observations are made.

(a) Although a sum of Rs.2,224,380 had been written off as amortization of Government Grants during the year under review, the policy relevant to the amortization of Government Grants had not been disclosed in the financial statements.

(b) The office of the Local Loan and Development Fund had been maintained in a building belonging to the Food Commissioner's Department and the land with this building had been alienated to the Pakistan High Commissioner's Office upon a Government decision. However, a sum of Rs.4,511,406 spent by the Fund for the renovation of the above building for which there was no legal ownership or temporary ownership had been capitalized, whereas no policy had been recognized for writing off the above expenditure.

2.2.5 Accounting Deficiencies

The following observations are made.

(a) A sum of Rs.1,482,905,606 had been granted to the Local Authorities as loans and grants as at 31 December 2015, whereas action had not been taken to recognize the value of the grants included in this balance and write off against the profit.

(b). As the value of 07 Laptops purchased at accost of Rs.1,150,331 during the year under review had been debited to the Computer Maintenance Account, the cost of Property, Plant and Equipment and the net profit of the year under review had been understated by that amount in the accounts.

(c). Accrued expenditure of Rs.144,082 as at 31 December 2015 had been understated in the account and loan interest income of Rs.57,965,835 relevant to the year under review had not been brought to account.

(d). As interest income of Rs.8,445,245 directly invested under the fixed deposits from the year 2012 up to December of the year under review had been omitted from the accounts, value of the fixed deposits had been understated by that amount while surplus and retained earnings of the year under review had been understated by Rs.1,932,324 and Rs.6,512,921 respectively .

2.2.6 Unexplained Differences

The following observations are made.

(a) According to the financial statements as at 31 December of the year under review, although the opening balance of the expenditure on furniture and fittings amounted to Rs.5,150,873, that balance was Rs. 606,563 according to the schedule made available to the Audit. Accordingly, a difference of Rs.4,544,310 was observed.

(b) According to the financial statements as at 31 December 2015, a difference of Rs.389,178,319 was observed between the debtors balances and receivable loan interest balances, and the balances as per the schedule, whereas action had not been taken to recognize the above different and carry out the necessary corrections.

(c) According to the financial statements as at 31 December of the year under review, balances of a bank current account and a savings account totalled Rs.180,963,215 and that balance amounted to Rs.179,588,931 according to the cash book and the balance confirmations. Accordingly, a difference of Rs.1,374,284 was observed, whereas action had not been taken to recognize the above different and correct the same.

2.2.7 Lack of Documentary Evidence for Audit

Since the evidence indicated against the following item of accounts had not been made available to Audit, those could not be satisfactorily examined or accepted in audit.

	Item of Account	Value Rs.	Audit Evidence not Furnished
(a)	Fixed Deposit Investments	24,640,898	Balance confirmations, Fixed deposit certificates
(b)	Allocation of office rent	7,200,000	Detailed Computations and schedules
(c)	Investment income receivable	2,522,742	
(d)	Interests on loans payable to the Treasury.	21,765,948	
(e)	Doubtful receipts	22,063,699	
(f)	Receipt of Advances	15,623,577	

2.3 Non-compliance with Laws, Rules, Regulations and Management Decisions

Following non-compliances with laws, rules, regulations and management decisions were observed.

	Reference to Laws, Rules and Regulations	Non-compliance
(a)	Treasury Circular No.842 dated 19 December 1978	Register of Fixed Assets had not been maintained in an updated manner by correctly including all the details relating to fixed assets.
(b)	Treasury Circular No.IAI/2002/02 dated 28 November 2002.	A register had not been maintained on computers and computer accessories.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Fund during the year under review had resulted in a surplus of Rs.4,226,504 as compared with the corresponding surplus of Rs.135,412,981 in the preceding year, thus showing an improvement of Rs.139,639,485 in the financial results of the year under review as compared with the preceding year. The decrease in the net amortization relating to the Grants by Rs. 105,219,502 and expenditure written off as the loan impairment by Rs. 70,377,085 during the year under review had mainly attributed for the above improvement of the financial result.

In analyzing financial statements of the year under review and 3 preceding years, although a continuous deficit in the financial result was observed from the year 2012 to the year 2014, that deficit had decreased from Rs.337,504,858 to Rs.135,412,981 and it had turned out to be a surplus of Rs.4,226,504 during the year under review. However, when readjusting employees remuneration, tax paid to the Government and depreciations for the non-current assets to the financial result, a negative contribution was observed from the year 2012 to 2014. Nevertheless, it had decreased from Rs.106,622,894 to Rs.18,499,306. However, contribution of the year under review had become a positive value of Rs.53,215,095 .

4. Operating Review

4.1 Performance

4.1.1 Planning

Although the Fund had prepared an Action Plan, it had not been prepared by including the Annual Budget (income, operational expenditure, expenditure on development, statement of financial position, cash flow statement) proposed investments, Annual Procurement Plan (expansion of major investment capacities, major procurements) Human Resources Development Plan, Loan Repayment Plan/ Loan Recovery Plan and the Internal Audit Plan, as stipulated in the Public Finance Circular No.01/2014 dated 17 February 2014.

4.1.2 Operations and Review

The following observations are made.

(a) The revenue of the Fund had comprised the balance remained after the payment of the capital amount of loans and a part of the interest recovered to the Treasury out of the loans granted to the Local Authorities by the Local Government Infrastructure Improvement Project (LGIIP), Urban Development Low Income Housing Project (UDLIHP) and Perennial Crops Development Project (PCDP) to develop the fixed assets of those institutions for strengthening the Local Authorities and the interest recovered from the loans given by the Fund to the Local Authorities. Hoverer, out of 38 loan balances valued at Rs.648,882,366 existed in the nonperformance loan list for more than a period of one year by the end of the year under review, only 13 loan balances valued at Rs.116,968,939 had been rescheduled during the year 2015, whereas an effective measure had not been taken to recover the balance of Rs.531,912,427.

(b) Although the main source of income of the Fund is the interest earned from granting loans, no promotion porgramms had been implemented for the issue of new loans during the year under review and it was observed in audit that only 03 loans valued at Rs.27,800,000 had been approved by the Board of Commissioners.

(c) An analysis of the loans approved provincial wise in the preceding years and granted in the year under review is given below.

Province	**Estimated Amount Rs.**	**Actual Amount Rs.**	**Progress %**
Central	50,000,000	10,802,270	22
Eastern	40,000,000	7,664,000	19
North-central	50,000,000	16,000,000	32
Northern	70,000,000	9,400,000	13
Southern	60,000,000	3,360,000	6
North-western	120,000,000	13,500,000	11
Sabaragamuwa	20,000,000	20,438,400	102
Uwa	20,000,000	4,108,000	21
Western	70,000,000	207,317,000	296
Total	500,000,000	292,589,670	

In analyzing the grant of loans provincial wise, the progress of the provinces other than the Western Province and the Sabaragamuwa Province remained t less than 32 per cent.

4.2 Management Activities

The following observations are made.

(a) The Board of Commissioners comprising 14 members including 9 Local Government Commissioners chaired by the Secretary to the Ministry of Provincial Council and Local Government had met only in four instances during the year under review. Since approving of loans and taking other management decisions are carried out by the Board of Commissioners, the inadequate contribution of the Board of Commissioners had adversely affected the performance of the Fund.

(b) In terms Section 03 of the Local Loan and Development Ordinance No.22 of 1916 as amended by the Local Loan and Development (Amendment) Act, No.24 of 1993, the Board of Commissioners shall have the powers to appoint the staff. Nevertheless, without the approval of the Board of Commissioners, the Secretary to the respective Ministry had appointed an officer in the Accountant Service to act/ discharge duties of the post of Director of the Fund. Further, acting allowance of Rs.176,248 contrary to the Sections 12:5:4 and 12:8 of Chapter VII of the Establishments Code of the Democratic Socialist Republic of Sri Lanka and contrary to the Paragraph 5 of the Public Enterprises Circular No.PED/50 dated 28 July 2008 and Paragraph 3.7 of the Public Enterprises Circular No.PED 1/2015 dated 25 May 2015, sums totalling Rs.617,258 comprising transport allowance of Rs.270,000 and fuel allowance Rs.171,010 had been paid to the above officer.

5. Accountability and Good Governance

5.1 Internal Audit

An internal Auditor had not been appointed to the Fund and an adequate audit had not been carried out by the Line Ministry.

6. Systems and Controls

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

Area of systems and controls	Observation
(a) Accounting	(i) Transactions of the Fund had not been properly recorded and accounts books had not been correctly maintained.
	(ii) Accounting and operating activities had not been carried out by using the computer system purchased and installed by the Fund in the year 2012.
(b) Control of Loan Recovery	An adequate arrangement had not been made to recover the loan installments and the interest receivable to the Fund.