

Local Loans and Development Fund – 2016

The audit of financial statements of the Local Loans and Development Fund for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the statement of comprehensive income and statement of cash flow 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 18 May 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 2016 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Financial Reporting Standards and Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Presentation of Financial Statements

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 responsibility 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 had been balanced by including a sum of Rs.2,501,824 as a debit balance in the Suspense Account under the current assets and a sum of Rs.22,063,699 as a credit balance under the current liabilities in the Suspense Account.

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 with the financial statements 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 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.

(b) Sri Lanka Accounting Standard 07

The following observations are made on the cash flow statement.

- (i) Although payment and receipt of interest of the financial institutions can be stated as their operating activities, payment of interests amounting to Rs. Rs.155,603,616 and receipt of interests amounting to Rs.305,633,906 relevant to the Fund had been again added to the profit in the preparation of financial statements of the Fund.
- (ii) Although the depreciation value stood at Rs.3,270,293 relating to the year under review in accordance with the financial statements, it had been stated as Rs.3,776,138 in the cash flow statement and as such, the cash flow statement had been overstated by Rs.505,845 before adjusting the working capital variations.
- (iii) According to the statement of financial position as at 31 December 2016, decrease of the debtors amounted to Rs.388,761,890, whereas it had been stated as Rs.399,363,835 under the capital item variation and as such, cash inflow had been overstated by Rs.10,601,945.
- (iv) Although the amortization of Grants given to Local Authorities-LGIIP amounting to Rs.54,773,440 should be adjusted to the before tax profit in the calculation of cash flow generated from the operating activities, it had been adjusted under the working capital variations.
- (v) According to the statement of financial position, the increase in the interest account payable to the Treasury amounted to Rs.72,318,793 and it should have been stated as a cash inflow under the working capital variation in the cash flow statement . Nevertheless, it had been stated as a cash outflow of Rs.94,084,745.
- (vi) Although the loans granted to the Local Authorities had been represented through the debtors, a sum of Rs.144,644,000 had been shown again as the payment of loans to the Local Authorities in the cash flow statement under the financial activities.

(vii) Loan impairment value of Rs.142,363,848 brought to account relating to the year under review had not been adjusted in the computation of cash flow generated from the operating activities.

(c) Sri Lanka Accounting Standard 12

Main segments of the tax expenditure/liability had not been separately recognized and disclosed in terms of Paragraph 79 of the Standard.

(d) 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 that, an accounting policy had been recognized stating the fact that the assets are not depreciated in the year of purchase.

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

(e) 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 in connection with the post employee benefits 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) 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.3,851,639 spent by the Fund for the renovation of the above building for which there was no legal ownership or temporary ownership had been capitalized under the buildings, whereas no policy had been recognized for writing off the above assets.

(b) Although a sum of Rs.5,275,731 had been shown as the capital grants balance in the statement of financial position as at 31 December of the year under review, an accounting policy had not been recognized under a formal basis in accordance with Paragraph 12 of Sri Lanka Accounting Standard 20 for identifying it as an income.

2.2.5 Accounting Deficiencies

The following observations are made.

- (a) Although the net value of the Property, Plant and Equipment amounted to Rs.12,838,773 as at 31 December 2016, due to erroneous computation, it had been stated as Rs.16,069,192 in the Note 1 of the statement of financial position presented to audit. Accordingly, value of the Property, Plant and Equipment had been overstated by Rs.3,230,419.
- (b). According to the financial statements, annual depreciation value of the Furniture and Fittings relating to the year under review amounted to Rs.275,298, whereas it was Rs.30,328 as per the schedule furnished to Audit. Accordingly, depreciation relating to the year under review had been overstated by Rs. 244,970.
- (c). Although the cost of the Laptops accounted under the LLDF Modernization Assets Class had been transferred to the Computer Hardware, Software and Office Equipment Account, accumulated depreciation value of Rs.2,395,166 relating to the above assets had not been transferred to the relevant provision for depreciation account. Further, a sum of Rs.198,041 exceeding the depreciable value of the above assets had been depreciated and as such, surplus and the net value of the assets of the year under review had been understated by that amount.
- (d). Even though the investment value of the Repurchase Agreements (REPO) of the Fund as at 31 December 2016 had been stated as Rs.180,600,000 in the statement of financial position, it was Rs.180,000,000 according to the confirmations of bank balance. Accordingly, investment value had been overstated by Rs.600,000.
- (e). Although a sum of Rs.329,400 had been stated as Commissioner Board advances as at 31 December 2015, this amount had not been brought forward as the opening balance of the year 2016 and as such, the balance of that account had been understated by that amount.
- (f). Although the balance of the provision for gratuity account amounted to Rs.2,915,417 according to the financial statements as at 31 December 2015, that balance had been brought forward as Rs.4,609,931 as at 01 January 2016. Accordingly, the balance of the provision for gratuity account as at 31 December 2016 had been overstated by Rs.1,694,514.
- (g). The value of loan installment amounting to Rs.2,662,767 received in the preceding year relating to the year 2016 had been further stated under the current liabilities without being credited to the debtors account during the year under review .
- (h) Allowance for Chairman of Rs.1,197,325 relevant to the year under review had been accounted twice.

- (i) Interest income on fixed deposit of Rs.2,773,976 and interest income on the investments in Treasury Bills of Rs.2,539,706 receivable relating to the year under review had not been brought to account.
- (j) Interest of Rs.18,243,168 payable as at 31 December 2016 to the Treasury under the Urban Development and Low Income Housing Project (UDLIHP) had been understated in the account.
- (k) According to the statement of financial position, a sum of Rs.360,000 had been allocated as audit fees relating to the year under review, whereas that amount had not been recognized as an expenditure in the statement of comprehensive income.

2.2.6 Unexplained Differences

Although the value relating to 11 items of accounts as at 31 December 2016 amounted to Rs.960,711,969 according to the financial statements, that balance totalled Rs.1,166,388,480 according to the schedules/ledgers relevant thereto, thus observing a difference of Rs.382,727,868.

Item of Account	Value as per the financial statements Rs.	Value as per the schedule Rs.	Value as per the ledger Rs.	Difference Rs.
(a) Debtors	119,843,374	129,925,205		10,081,831
(b) Loan Interests Receivable	203,937,342	477,673,989		273,736,647
(c) Property, Plant and Equipment	15,463,246	9,927,804		5,535,442
(d) Opening balance of Computer, Software, Hardware and Office Equipment	75,463	6,895,602		6,820,139
(e) Interest Income	305,633,907	290,822,282		14,811,625
(f) Repurchase Agreements	46,629,168	36,638,566		9,990,602
(g) Balances of 03 Current Accounts	199,156,820	-	146,025,749	53,131,071
(h) Investments	52,628,805	49,255,849		3,372,956
(i) Property Loan	475,053	2,038,525		1,563,472
(i) Distress Loan	4,882,506	3,198,624		1,683,883
(j) Advance of the Local Government Infrastructure Development Project	11,986,285	-	13,986,285	2,000,000
Total	<u>960,711,969</u>	<u>1,006,376,446</u>	<u>160,012,034</u>	<u>382,727,868</u>

2.2.7 Lack of 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.

<u>Item of Account</u>	<u>Value</u> Rs.	<u>Audit Evidence not Furnished</u>
(a) Fixed Deposit Investments	24,640,898	Balance confirmations, Fixed deposit certificates
(b) Deposits Recoverable	40,052	Detailed computations/Schedules
(c) Interest on loan relating to Perennial Crops Development Project (PCDP)	4,077,810	
(d) Writing off of the capital included in the loans given to the Local Authorities.	54,773,440	
(e) Impairment of loans	142,363,848	
(f) Receipt of Advances	51,698,087	
(g) Provision for Gratuity	1,694,514	Actuarial Assessment Report

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

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

<u>Reference to Laws, Rules and Regulations</u>	<u>Non-compliance</u>
(a) Treasury Circular No.842 dated 19 December 1978	Register of Fixed Assets had not been maintained in an updated manner by 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.3,569,413 as compared with the corresponding surplus of Rs.4,226,494 in the preceding year, thus showing a deterioration of Rs.657,081 in the financial results of the year under review as compared with the preceding year. Although income of the year under review had increased by Rs.61,375,457 as compared with the preceding year, increase in the expenditure by Rs.62,032,538 had mainly attributed for the above deterioration of the financial result.

In analyzing financial statements of the year under review and 4 preceding years, although a continuous deficit in the financial result was observed from the year 2012 to the year 2014, that deficit had continuously decreased from Rs.337,504,858 to Rs.135,412,981 and a surplus of Rs.4,226,504 and Rs.3,560,413 was observed in the year 2015 and 2016 respectively. Further, 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 2015 had been a positive value of Rs.53,215,095 and it had increased up to Rs.173,248,771 by the end of the year under review.

4. Operating Review

4.1 Performance

4.1.1 Planning

Although the Fund had prepared an Action Plan for the year 2016, it had not been prepared in accordance with the Public Finance Circular No.01/2014 dated 17 February 2014.

4.1.2 Operation 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 (LGIIIP), 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. However, out of 28 loan balances valued at Rs.552,027,729 existed in the inoperative loan list for more than a period of one year by the end of 2016, only 11 loan balances valued at Rs.104,367,052 had been rescheduled during the year under review, whereas an effective measure had not been taken to recover the balance of Rs.447,660,677. Further, the Fund had not prepared an age analysis relating to the loan installments in arrears and the interests.

- (b) Although a sum of Rs.800,000,000 had been allocated for granting loans to the Local Authorities during the year under review, only a sum of Rs.144,648,000 had been granted to 5 Local Authorities. Accordingly, the progress thereof had remained at a lower level as 18 per cent. Further, in analyzing the granting of loans at provincial wise, any loan had not been granted to the Central, North- central, North and North-western provinces.

4.2 Management Activities

The following observations are made.

- (a) Although the grant of loans to the Local Authorities and the recovery of such loans are the functions of the Fund, proper accounting methodology had not been introduced to recognize interest and the capital separately in the recovery of those loans.
- (b) Although a sum of Rs.1,391,772 had been received from the Puttalam Urban Council in the year 2016, it had been returned without being utilized for the settlement of a part of the sum of Rs.27,835,570 receivable from the Council.
- (c) 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 Commissioners Board shall have the powers to appoint the staff. Nevertheless, without the approval of the Commissioners Board, the Secretary to the Ministry of Public Administration and Provincial Councils and Local Government had appointed a Class I officer in the Accountant Service on acting/ discharging of service basis. Further, 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.1,244,905 had been paid to the above officer as the salary for acting service, fuel, and transport allowances.

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 and maintenance of books

(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 updating the computer system purchased and installed by the Fund in the year 2012.

(b) Control of Loan

An adequate arrangement had not been made to recover the loan installments and the interest receivable to the Fund.