

## **Local Loans and Development Fund – 2017**

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The audit of financial statements of the Local Loans and Development Fund for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of comprehensive income 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.

### **1.2 Management’s Responsibility for the Financial Statements**

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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**

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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 Qualified Opinion**

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My opinion is qualified based on the matters described in paragraph 2.2 of this report.

## **2. Financial statements**

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### **2.1 Qualified Opinion**

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In my opinion except for the effects of the matters described in paragraph 2.2 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 2017 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**

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#### **2.2.1 Sri Lanka Accounting Standards**

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The following observations are made.

(a) **Sri Lanka Accounting Standards 07**

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- (i) According to the Paragraph 33 of the Standard, interest paid from the institute and interest received by the institute should be considered as operating activities in the preparation of financial statements by the financial institutions. Nevertheless, without being complied with that, Treasury interest of Rs.138,318,476 had been eliminated from the operating expenditure and it had been stated under financial activities in computing cash flow generated from the operating activities. As a result, the actual cash flow generated from the operating activities and the financial activities was not demonstrated by the cash flow statement.
- (ii) According to the statement of financial position of the year under review, the net cash flow received from the debtors amounted to Rs.106,174,066, whereas it had been stated as Rs.110,069,432 in the cash flow statement and as such, the net cash flow generated from the operating activities had been understated by Rs.3,895,366.

(b) **Sri Lanka Accounting Standard 16**

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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 Standard, an accounting policy had been recognized to the effect that the assets are not depreciated in the year of purchase .

#### **2.2.2 Accounting Policies**

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The following observations are made.

- (a) An accounting policy had not been established for the recognition of loan installments and interest defaulted debtors balances, as nonperforming loans.

- (b) Even though a sum of Rs.136,576 relating to the assets valued at Rs.11,449,133 received by the institution as the Government Grants from the projects implemented under the Line Ministry had been written off as amortization during the year under review, the accounting policy applied for the relevant amortization had not been disclosed in the financial statements.

### 2.2.3 Accounting Deficiencies

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Loan interest amounting to Rs.411,119 received in the preceding year relating to the year under review had not been brought to account as the interest income of the year under review and as such, surplus of the year had been understated by that amount.

### 2.2.4 Unexplained Differences

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Although a sum of Rs.4,312,648,250 had been stated as loans and receivable items as at 31 December 2017 in the financial statements, that balance totalled Rs.3,858,787,730 according to the schedules relevant thereto. Accordingly, a difference of Rs.453,860,520 was observed.

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

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

<b>Reference to Laws, Rules and Regulations</b>	<b>Non-compliance</b>
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<p>(a) Financial Regulation of the Democratic Socialist Republic of Sri Lanka. (i) 454 and 753 (3)(a)(1)</p> <p>(ii) Financial Regulation 754</p>	<p>In the issue of articles for the use of officers in the institution, those should be issued after entering in a distribution register, whereas articles had been issued after making entries in the inventory book as the issuance of articles.</p> <p>In terms of the Financial Regulation, the Inventory Book must be balanced and brought forward at the end of each financial year. Nevertheless, action had not been taken accordingly.</p>
<p>(b) Treasury Circular No.842 dated 19 December 1978</p>	<p>Although a Register of Fixed Assets had been maintained, details such as the type of asset, date of purchase, useful life, colour, model etc. relevant to the asset had not been included therein.</p>

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| (c) Treasury Circular No.IAI/2002/02 dated 28 November 2002.                             | A register had not been maintained on computers and computer accessories as required by the Circular.   |
| (d) Paragraph 4 of the Public Enterprises Circular No.PED/1/2015 dated 25 December 2015. | Without being complied with the Circular, a transport allowance totalling Rs. 70,000 at Rs.17,500 per month had been paid from November 2017 to two Deputy Directors who were entitled to group transport facility. |

### **3. Financial Review**

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#### **3.1 Financial Results**

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According to the financial statements presented, the operations of the Fund during the year under review had resulted in a surplus of Rs.16,083,651 as compared with the corresponding surplus of Rs.2,826,072 in the preceding year, thus showing an improvement of Rs.13,257,579 of the surplus of the year under review as compared with the preceding year. Although amortization of Grants had increased by Rs.201,859,892 during the year under review, increase in the interest income by Rs.38,781,024 and decrease in the expenditure written off as the loan impairment by Rs.107,601,454 had mainly attributed for the above improvement of the financial result.

In analyzing financial statements of the year under review and 4 preceding years, although a deficit of the financial result was observed during the years 2013 and 2014, a surplus was observed from the year 2015 up to the year under review and it had increased from Rs.4,226,504 up to Rs.16,083,651. However, when readjusting employees remuneration, tax paid to the Government and depreciations for the non-current assets to the financial result, a negative contribution of Rs.88,492,034 and Rs.18,499,306 was observed during the years 2013 and 2014 respectively, whereas it had turned out to be a positive value from the year 2015. However, that contribution amounting to Rs.53,215,095 in the year 2015 had increased up to Rs.173,248,771 during the year 2016. Nevertheless, it had decreased up to Rs.79,223,754 during the year under review.

### **4. Operating Review**

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#### **4.1 Performance**

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##### **4.1.1 Planning**

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Although the Fund had prepared an Action Plan, the annual budget, proposed investments, annual procurement plan and human resources development plan, loan repayment/ recovery plan and internal audit plan required to be included in the said Action Plan in accordance with the Public Finance Circular No.01/2014 dated 17 February 2014, had not been included.

#### **4.1.2 Operation and Review**

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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. However, out of 17 loan balances valued at Rs.542,623,411 existed in the nonperforming loan list for more than a period of one year by the end the year under review, only 09 loan balances valued at Rs.235,912,902 had been rescheduled during the year 2017, whereas an effective measure had not been taken to recover the balance of Rs.306,710,509.

#### **4.2 Management Activities**

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The following observations are made.

- (a) 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, then Secretary to the relevant Ministry had appointed an officer in the Accounting Service to act/ discharge the duties of the post of Director. Further, contrary to the Sections 12:5:4 and 12:8 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 comprising Rs.382,056, Rs.522,000 and Rs.340,849 had been paid to the above officer as the salary for acting service, fuel allowance and transport allowances respectively in the years 2015 and 2016.
- (b) 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.
- (c) The Fund had not prepared an age analysis relating to the loan installments in arrears and the interest.

#### **4.3 Staff Administration**

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The following observations are made.

- (a) In pursuance of the Cabinet Decision No.16/1975/744/018 dated 26 November 2016, an officer had been recruited to the post of Director for a period of one year from 09 November 2016 on contract basis. According to the Recommendation iii of the said

Cabinet Decision, instructions had been given to the Secretary to the Ministry of Local Government and Provincial Councils to take necessary action to recruit an officer who has satisfied the qualifications specified in the scheme of recruitment to the above post after a period of one year. Nevertheless, without being taken action accordingly, the service of the officer who had not satisfied the qualifications stated in the scheme of recruitment had been further extended by one year.

- (a) Out of the total cadre of 34 of the Fund, duty assigning letters had not been issued for 06 officers. Deficiencies were observed in the performance of duties entrusted according to the duty assigning letters and the assigning of duties and proper attachment of the officers to the Divisions should have been carried out again.

#### **4.4 Resources of the Fund Released to Other Public Institutions**

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Although one driver only had been attached to the Local Loans and Development Fund, in terms of Letter dated 07 August 2016 of the Secretary to the Ministry of Provincial Council and Local Government, that driver had been attached to the personal staff of the Minister in charge of the subject from 06 September 2016 and this Fund had paid Rs.322,165 for the salary of the above driver by the end of 2017.

### **5. Sustainable Development**

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#### **5.1 Achievement of Sustainable Development Goals.**

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Every institution shall take steps in compliance with the Letter No.NP/SP/SDG/17 dated 14 August 2017 of the Secretary to the Ministry of National Policy and Economic Affairs and Agenda 2030 of the United Nations Sustainable Development Goals. Nevertheless, the Fund had not been aware of the manner in which it should take steps in connection with the functions coming under purview of the Fund. As such, the sustainable development goals and targets coming under purview of the Fund and milestones to be reached and the indicators to evaluate the performance of reaching those targets had not been recognized.

### **6. Accountability and Good Governance**

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#### **6.1 Internal Audit**

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

### **7. Systems and Controls**

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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**

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(a) Control over Recovery of Loan

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

(b) Accounting

Accounting and operating activities had not been carried out by using the computer system purchased and installed by the Fund in the year 2012.