Local Loans and Development Fund – 2013

The audit of financial statements of the Local Loans and Development Fund (the Fund) for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the statement of comprehensive income and retained earnings, and statement of cash flows 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

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. 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 judgment, including the assessment of the risks of material misstatement 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 the financial statements. Subsections (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 extent of the Audit.

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

1.4 Basis for Qualified Opinion

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

2. Financial Statements

2.1 Qualified Opinion

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 2013, 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 Compliance with Sri Lanka Accounting Standards (LKAS/SLFRS)

The following observations are made.

(a) LKAS 01 - Presentation of Financial Statements:

The following instances of non-compliance were observed.

(i) Comparative figures of Property, Plant and Equipment had not been disclosed in the financial statements.

(ii) The statement of changes in equity had not been presented with the financial statements for the year under review.

(iii) Significant accounting policies in relation to taxation and loan and receivables had not been disclosed and accounting policies relating to the Property, Plant and Equipment had not provided required information.

(iv) Although the financial statements had been restated, it had not been properly disclosed.

(v) Even though sub schedule numbers are mentioned in the notes to the financial statements, those had not been reflected in the financial statements.

(b) LKAS 10 –Events after the Reporting Period

The Company had not disclosed the date of the financial statements was authorized.

(c) LKAS 12 – Income Taxes

Differed tax asset/liability had not been recognized in the financial statements.

(d) LKAS 19 – Employee Benefits

Details such as current service cost, re-estimated net defined benefit liability and past service cost regarding the employee benefits had not been properly disclosed.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) The Fund had not recognized the interest income on fixed deposits of Rs.14,994,954 for the year under review. Hence, the profit for the year under review and value of investment as at 31 December 2013 had been understated by that amount.

(b) A sum of Rs.250,162,653 had been debited to the income statement as an amortization instead of Rs.209,499,354 due to erroneous computation. Therefore, the profit of the Fund for the year under review had been understated by Rs.40,663,299.

(c) The interest receivable in suspense and interest in suspense accounts as at 31 December 2013 had been overstated by Rs.242,627 as a result of erroneous calculation.

(d) Deficiencies observed in the recognition of income, loan balance and interest receivables on loans given to the Local Authorities are given below.

(i) Even though a sum of Rs.96,366,315 was shown in the financial statements as initial loans, those loans had been rescheduled as Rs.82,500,000 on 01 January 2012 resulting a loss of Rs.13,866,315 to the Fund. However, this had not been adjusted in the respective loan account and as such the loan balance had been overstated by Rs.13,866,315 as at 31 December 2013.

(ii) As Fund had reduced loan payable to General Treasury by Rs.13,866,315 with effect from 01 January 2012 without obtaining approval from the Treasury, it had to pay interest to Treasury on initial loan and therefore, the Fund had excessively paid Rs.1, 455,963 as interest for the period of 2012 and 2013.

(e) The loans and receivables shown in the statement of financial position as at 31 December 2013 had been understated by Rs.23,262,479 due to deducted not only provision for bad debt but also provision for impairment.

(f) According to the loan schedule of the Local Government Infrastructure Improvement Project (LGIIP), interest income for the year and interest receivable as at 31 December 2013 were Rs.167,146,395 and Rs.93,305,400 respectively. However, it was shown in the financial statements as Rs.147,407,845 and Rs.74,931,381 respectively. Hence, the interest income and interest receivables as at 31 December 2013 had been understated by Rs.19,738,550 and Rs.18,374,019.

(g) The LLDF loan installments of Rs.510,000 had remained in the advance account for more than one year without transferring to the relevant accounts. As such, the loan balances shown in the financial statements had been overstated by similar amount as at 31 December 2013.

(h) According to the loan schedule the interest income on the loans provided by the Fund for the year under review was Rs.52,956,299. However, a sum of Rs.51,154,999 had only been shown in the financial statements as interest income. Therefore, the interest income for the year under review had been understated by Rs.1,801,300. Further, interest for a loan worth Rs.8,364,306 had not been calculated and brought to the accounts.

(i) Although interest income for the year should be Rs.126,512,986 as per the loan ledger and interest calculation schedules of the Urban Development Low Income Housing Project (UDLIHP), a sum of Rs.92,909,677 only had been taken into account as income. Thus, the interest income had been understated by Rs.33,603,309 during the year under review.

(j) The interest income on fixed deposits and treasury bills for the year 2012 amounting to Rs.1,216,741 and Rs.1,306,001 respectively relating to the UDLIHP had been erroneously taken as an income for the year 2013. Thus, the interest income for the year under review had been overstated by Rs.2,522,742 in the financial statements. Further, an interest income of Rs.946,810 on a loan given to an Urban Council related to the year 2012 had been treated as income for the year 2013. Hence, interest income had been overstated by similar amount.

(k) According to the accounting policies disclosed in the financial statements, it was stated that the depreciation on office furniture should be calculated at a rate of 5 per cent per annum. However, the depreciation for office furniture purchased at a cost of Rs.454,020 in the year 2008 had been calculated at a rate of 20 per cent per annum. As such cumulative depreciation as at 31 December 2013 and depreciation for the year under review had been overstated by Rs.317,814 and Rs.41,618 respectively.

(l) The loan balance as at 31 December 2013 relating to the Local Government Infrastructure Improvement Project had been overstated by Rs.4,068,968 due to incorrect recognition of grant balance in the loan account.

2.2.3 Un-reconciled Differences

Un-reconciled differences aggregating Rs.41,860,918 related to 09 accounts were observed between the balances shown in the financial statements and the corresponding records.

2.2.4 Unidentified Differences

Differences totalling Rs.16,921,025 were observed between the interest receivable balances shown in the financial statements and the corresponding balances shown in the schedules submitted for audit and the reasons for these differences were not explained to audit.

2.3 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
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(a)	Financial Regulation 754	Even though the Fund had purchased stationaries, 24 office bags and 40 calculators worth Rs.300,157, Rs.90,180 and Rs.35,270 respectively during the year under review, movements of inventory had not been properly updated. Further, the Boards of Survey for the year 2013 had not been conducted even up to the end of the year under review.
(b)	Scheme of Recruitments followed by the Fund.	All the appointments to the Fund should be done in accordance with the Scheme of Recruitments of the Fund. In contrary to that, the officer who did not have basic educational qualifications required for the post had been appointed as Deputy Director (Operation) in the year 2012 and that officer is being functioning the duties of such post up to the end of the year 2013.
(c)	Treasury Circular No. IAI/2002/02 of 28 November 2002	A register for computers, computer accessories and software had not been maintained.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Fund for the year ended 31 December 2013 had resulted in a pre-tax net loss of Rs.246,455,922 as compared with the corresponding pre-tax net loss of Rs.335,404,859 for the preceding year, thus indicating an improvement of Rs.88,948,937 in the financial result for the year under review. Increase of interest income on loans granted by Rs.14,991,233 and decrease of impairment for loan by Rs.146,210,891 were the main reasons attributed for this improvement.

The value addition of the Fund for the year under review after taking into account the depreciation, tax expenses and personal emoluments aggregating Rs.14,351,144 was negative value of Rs.233,904,778.

3.2 Analytical Financial Review

3.2.1 Significant Accounting Ratios

According to the information made available, some important accounting ratios of the Fund for the year under review and preceding year are given below.

Ratios	2013	2012
Net loss to Total income (percentage)	73.75	102.77
Current Asset Ratio (Number of Times)	16.7:1	119:1
Staff Cost to Operating Expenses (percentage)	4.8	4.5

(a) According to the financial statements presented to audit, the Fund had reported losses since the year 2012. However, the net loss ratio had decreased from 102.77 per cent in the year 2012 to 73.75 per cent in the year 2013 due to decline of net loss by Rs.89,248,937 in the year 2013.

(b) The Fund had reported a higher current asset ratio mainly due to recognition of loan and receivable under current assets and maintenance of considerable deposits in saving accounts.

4. Operating Review

4.1 Performance

The following observations are made

(a) According to Section 5 of the Local Loans and Development Fund (amendment) Act, No. 24 of 1993, the purpose for which loans may be granted by the Fund is for any work of public utility including technical assistance. Accordingly, the Fund had provided loans under five projects and the outstanding balances as at the end of the year 2013 and preceding year is as follows.

Name of the Projects	**Outstanding Loan Balances as at 31 December**	
	2013	**2012**
	Rs.	**Rs**
Local Loan and Development Fund (LL&DF)	619,124,948	517,621,456
Urban Development and Low Income Housing Project (UDLIHP)	1,706,194,130	1,788,745,619
Local Government Infrastructure Improvement Project (LGIIP)	1,735,734,362	1,729,974,677
Personal Crop Development Project (PCDP)	69,356,658	70,733,648
Projects for National Water Supply and Drainage Board (NWS&DB)	9,215,880	9,995,449
Total	**4,139,625,978**	**4,117,070,849**

According to available information, the financial facilities of more than 83 per cent and 85 per cent had been provided to the Local Authorities under the UDLIHP and LGIIP respectively. However, the Fund had not set out targets for granting loans from these Projects.

(b) A sum of Rs.300 million had been allocated for providing loans for various activities during the year under review and out of that a sum of Rs.225.47 million had been given as loans during the year under review. The progress of this loan is summarized and shown below.

Name of Activity	**Allocation of Fund**		**Funds Disbursed during the year**		**Utilization of Fund as percentage of Allocation**
	Number of Projects	**Amount**	**Number of Projects**	**Amount**	**-**
		Rs. Mn.		**Rs.Mn.**	
Purchase of Machineries and Equipment	15	75	25	197.86	264
Construction of Office Building, Libraries and Memorial Halls	3	25	-	-	-
Construction of Crematoriums	4	25	1	1.97	8
Construction of Weekly Fairs and Economic Centers	6	30	4	10.65	36
Construction of Market Buildings	4	50	3	14.99	30
Environmental and Tourism Projects	-	10	-	-	-
Development of Roads	-	20	-	-	-
Waste Management Projects	2	25	-	-	-
Water Projects	2	15	-	-	-
Other Revenue Earning Projects	8	25	-	-	-
Total	**44**	**300**	**33**	**225.47**	**75**

The following observations are made in this regard.

(i) Even though the Fund had allocated a sum of Rs.120 million for five activities including waste management, those activities had not been initiated even in the year under review.

(ii) Out of other activities, the performance at the end of the year appeared to be less than 40 per cent except the funds allocated for purchase of machineries and equipment. The Fund had spent Rs. 197.86 million for purchase machineries and equipment even though only Rs. 75 million had been allocated for this purpose. However, other activities which Rs.225 million have been allocated were the significant functions of the Local Authorities.

4.2 Idle Assets

A sum of Rs.1,302,214 had been spent for purchase and installation of local area network (software) in 2009 under the Local Government Infrastructure Improvement Project for the purpose of disbursement and recovery of loans. However, this asset had been remained idle since the date of installed.

4.3 Identified Losses

The software purchased in year 2009 for Loan Management Systems and Financial Accounting at a cost of Rs.235,200 had not been used for the intendant purpose as it was not suite with the need of the Fund.

4.4 Human Resources Management

The following observations are made.

(i) Five officers were appointed in time to time as Chief Executive Officer (CEO) of the Fund since 2010 to 31 December 2013. Further, the current CEO also had been appointed only for a period of one year. Hence, change of such key positions frequently may affect the smooth function of the Fund.

(ii) Although assistant accountant of the Fund had been appointed as Deputy Director (Finance & Administration) in two instances by the Board of Commissioners during the year 2014, he had not been issued a formal letter of appointment even up to the end of the year 2014. Further, Board of Commissioners at the meeting held on 29 December 2015 had decided to appoint another person as Deputy Director (Finance and Administration) with effect from as at 01 August 2015.

5. Accountability and Good Governance

5.1 Internal Audit

The Internal Auditor of the line Ministry had been appointed to cover the internal audit functions of the Fund. However, only one audit query had been issued during the year under review and adequate actions had not been taken to appoint a permanent Internal Auditor to cover the major risk areas of the Fund until end of the year 2013.

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.

	Control Area	Observations
(a)	Accounting	Some entries which were passed to correct errors made in 2012 in the income statement had been erroneously carried forward for the year 2013. Further, general ledger had not been properly maintained by the Fund.
(b)	Recovery of outstanding loans and interest	It was not observed in implementation of a formal plan to recover the loans. Accordingly, the most of loans given by the Fund were reported as in arrears. Further, some non-performing loans had been rescheduled without considering profitability to the Fund and adjustments for most of such rescheduled loans had not been made in the financial statements as per the rescheduled information.