

Local Loans and Development Fund – 2014

The audit of financial statements of the Local Loans and Development Fund (“the Fund”) for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 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 the 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 adverse 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 2014 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 Fund had not recognized the interest income on fixed deposits on accrual basis in the financial statements for the year under review.

(b) LKAS 16 - Property, Plant & Equipment

(i) Although the depreciation of an asset should begin when it is available for use as per paragraph 55 of the Standard, the Fund had depreciated its assets from the year of purchase contrary to the provisions in the Standard.

(ii) The gross carrying amount of Rs. 1,023,128 relating to fully depreciated assets had not been disclosed as a note to the financial statements in terms of paragraph 79 of the Standard.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) Since the Fund had not computed its interest income on fixed deposits on accrual basis, interest income of Rs. 9,551,435 for the year under review and the interest receivable as at 31 December 2014 had been understated by Rs. 24,966,196.

(b). The interest income on fixed deposits and treasury bills had been taken into financial statements on net basis disregarding the withholding tax of Rs. 1,280,877 and notional tax of Rs.492,161 charged at the time of crediting the interest. Accordingly, profit for the year under review had been understated by Rs.1,773,038.

(c). Depreciation for the year under review for computers and office equipment had not been computed and charged to the income statement. Hence, the profit for the year under review and the value of Property, Plant and Equipment (PPE) as at end of the year under review had been overstated by Rs.906,423.

- (d). An amount of Rs.2,349,238 had been erroneously debited to PPE as addition to computer hardware & software in the year 2014. However, the details of credit entry made by the Fund thereon had not been presented to audit even up to the date of this report. Hence, the accuracy and reliability of the PPE shown in the statement of financial position could not be ascertained in audit.
- (e). Local Loans and Development Fund Modernization assets which were posted to General Ledger in year 2012 amounting to Rs.3,586,139 had been re-recognized as addition to the furniture and fittings in the financial statements for the year 2014. Further, staff training expense of Rs.958,169 was also recognized as an asset under furniture & fittings. Hence, the value of total assets and depreciation for the year under review had been overstated by Rs.4,544,308 and Rs.1,020,841 respectively.
- (f). Interest receivable on fixed deposits and treasury bills relating to the Urban Development Low Income Housing Project (UDLIHP) charged to the financial statements in the year 2012 amounting to Rs.1,216,741 and Rs.1,306,001 respectively had been received in the year 2013. However, this had been continuously brought forward to the financial statements as receivable.
- (g). A sum of Rs.19,500,745 had been shown as cash balance under current assets as well as current liabilities in the statement of financial position as at 31 December 2014. Action had not been taken to identify and recover or settle these balances as at the end of the year under review.
- (h) According to the loan schedule submitted to audit, interest receivable as at 31 December 2014 from Dambulla Municipal Council and Kandy Municipal Council were Rs.17,929,308 and Rs.21,948,185 respectively. However, these balances had not been brought to the financial statements for the year under review.

2.2.3 Going Concern of the Fund

According to the financial statements presented, the Fund is running at continuous losses since the year 2011 and it had resulted to significant deterioration in the value of net assets of the Fund. This event indicates a material uncertainty that may cast significant doubt on the Fund's ability to continue as a going concern unless there is a support from the General Treasury. Further, the financial statements of the Fund do not disclose this fact.

2.2.4 Unexplained Differences

The following observations are made.

- (a) A net difference of Rs. 700,805,504 was observed between the value of loans shown in the financial statements for the year under review and the corresponding records submitted to audit.
- (b) A difference of Rs.1,996,692,218 was observed between the debtor balances shown in the statement of financial position as at 31 December 2014 and the debtor balances considered for impairment provision. The reasons for the difference had not been explained to audit.

- (c) According to the confirmations received the total investments on treasury bills as at 31 December 2014 was Rs.70,454,440. However, it was shown in the financial statements as Rs.59,230,275. The reasons for the difference of Rs.11,224,165 were not made available for audit.
- (d) According to the bank confirmation, the balance in the saving deposit as at 31 December 2014 was Rs.43,502,811. However, it was shown in the financial statements as Rs.99,097,477. As such, the deposits in the savings account had been deferred by Rs.55,594,666.
- (e) Although as per the information made available the interest payable to General Treasury as at 31 December 2014 was Rs.5,784,198, it was shown in the financial statements as Rs.117,095,177. Hence, an unexplained difference of Rs.111,310,979 was observed between these two amounts.

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

Board of Commissioners had granted the approval on 03 October 2014 to reduce the interest rate for loans to the Urban Development and Low Income Housing Project from 10 per cent to 6 per cent per annum. However, the Fund had not taken action accordingly to reschedule the loans valued at Rs.617,697,468 as at 31 December 2014.

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 pre-tax net loss of Rs.134 million as compared with the corresponding pre-tax net loss of Rs.246 million in the preceding year, thus showing an improvement of Rs.112 million or 45 per cent in the financial results.

Increase of net interest income by Rs. 32,535,852 or 24.7 per cent and decrease of impairment and amortization by Rs.48,219,301 and Rs.55,060,150 or 33.2 per cent and 22 per cent respectively as compared with corresponding figures of the preceding year were the main reasons attributed for this improvement.

The value addition of the Fund had also shown a negative value of Rs.115,324,361 in the year under review and it was a negative value of Rs.233,530,390 in the preceding year too, thus the value addition had increased by Rs.118,206,029 as compared with the previous year.

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 for the preceding year are given below.

Ratio	2014	2013
Net loss to total income (Percentage)	39.07	73.75
Current Asset Ratio (Number of times)	23.19	16.7

According to the above computations, net loss to income had significantly reduced by 34.68 per cent in the year under review.

4. Operating Review

4.1 Performance

According to Section 5 of the Local Loans and Development (amendment) Act No. 24 of 1993, the purpose for which loans may be granted by the Fund is for any work of public utility, which such authority may be authorized by law to undertake including the technical assistance. Accordingly, the Fund had provided loans under five categories and the outstanding balance as at the end of the year 2014 and preceding year are as follows.

Loan category	Outstanding Loan Balance	
	As at 31 December 2014	As at 31 December 2013
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	Rs.	Rs.
Local Loans and Development Fund	816,654,556	638,603,693
Urban Development and Low Income Housing Project	1,711,357,137	1,761,718,573
Local Government Infrastructure Improvement Project	1,694,276,103	1,810,665,745
Perennial Crops Development Project	67,847,623	69,356,658
National Water Supply & Drainage Board	<u>8,717,505</u>	<u>9,215,880</u>
Total	<u>4,298,852,924</u>	<u>4,289,560,549</u>

The following observations are made in this connection.

- (a). According to the above information the Fund had provided the financial facilities of more than 83 per cent and 79 per cent in the year 2013 and 2014 respectively under Urban Development and Low Income Housing and Local Government Infrastructure Improvement categories.
- (b). Long outstanding loan balances as at 31 December 2014 was Rs. 2,335.23 million and it's comprised the capital arrears of Rs. 1,402.53 million and interest in arrears of Rs.932.70 million. Details are shown below.

Loan category	Initial Loan	Capital in Arrears	Interest in Arrears	Total in Arrears
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	Rs. Million	Rs. Million	Rs. Million	Rs. Million
Local Government Infrastructure Improvement Project	492.12	484.99	135.77	620.76
Local Loans and Development Fund	32.25	31.73	2.43	34.16
Perennial Crops Development Project	12.00	12.00	17.93	29.93
Urban Development and Low Income Housing Project	<u>919.45</u>	<u>873.81</u>	<u>776.57</u>	<u>1,650.38</u>
Total	<u>1,455.82</u>	<u>1,402.53</u>	<u>932.70</u>	<u>2,335.23</u>

- (i) The interest in arrears out of the total arrears as at 31 December 2014 in respect of LGIIP, PCDP and UDLIHP loans were 22 per cent, 60 per cent and 47 per cent respectively.
- (ii) The Fund had failed to provide an age analysis in respect of above outstanding loan balances.
- (iii) The loan amounting to Rs.12,000,000 given under Perennial Crops Development Project to the Dambulla Pradeshiya Sabha should be settled by 31 December 2010. However, no single installment had been recovered by the Fund even up to the end of the year under review.

4.2 Contract Administration

The following requirements in the Government Procurement Guidelines had not been followed by the Fund in respect of building renovation contract valued at Rs. 3,286,729 offered during the year under review.

- (a) Guideline 2.8.1(a) - Even though no member should serve in both Procurement Committee and Technical Evaluation Committee, a person was appointed as a member to both committees.
- (b) Guideline 5.2.1 - The bidding documents shall furnish all relevant information necessary for a prospective bidder to prepare the bidding documents. However, bid opening date and time were not provided in the bidding documents issued for this purpose.

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| (c) | Guidelines 5.3.1 and 5.3.5 (a) | - | Standard bidding documents had not been used for calling the bids and necessity for registration in the Institute of Constructions Training and Development had not been mentioned in the bidding documents |
| (d) | Guideline 6.1.4 | - | The Fund had not been kept a record pertaining to the issuance of the bid documents |
| (e) | Guideline 8.13.3 | - | Variations and contingency provision generally should not exceed ten per cent (10%) of the estimated contract. However, a variation of 107 per cent was observed with regard to this contract. |

4.3 Human Resources Management

According to the provisions in Finance Circular No. 124 dated 24 October 1997, the covering up duties of a vacant post should be limited to a period of 03 months. However, the Director or Chief Executive Officer and the Assistant Accountant of the Fund had been employed on acting basis since the year 2014.

4.4 Management Activities

The following observations are made.

- (a) According to the confirmation received from banks, the Fund had maintained a sum of Rs.43,502,810 in a bank account as at 31 December 2014 and the balance in this account as at 01 January 2014 was Rs. 158,587,835. Accordingly, the Fund had failed to manage its financial resources in order to obtain optimum income through investing excess fund in proper investment sources.
- (b) The Fund had amortized the grants received from the Government to the Fund and the grants given by the Fund by using a specified method. However, actions had not been taken to get approval from the Board of Commissioners for this method.

5 Accountability and Good Governance

5.1 Budgetary Control

Even though Fund had budgeted Rs.85 million for two activities including construction of office building, library and memorial halls and other revenue generating projects, those activities had not been even initiated during the year under review. Accordingly, Fund had utilized the funds allocated these projects to carry out other activities in the budget.

5.2 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. Since the Fund is making continuous losses since year 2011 and having a negative net assets of Rs,939,752,302 as at 31 December 2014, a separate internal audit division had not been implemented to cover the major risk areas of the Fund.

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 control	Observation
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(a) Accounting	The Fund to be taken fruitful actions to reduce unexplained differences in loan balances.
(b) Maintenance of Loan Files	Loans files are maintained without including required information
(c) Non-performing Loans	No stringent actions had been taken to recover the non-performing loan balances reported as at the end of the year under review.