Local Loan and Development Fund – 2022

---

1. Financial Statements

1.1 Disclaimer of Opinion

The audit of the financial statements of the Local Loan and Development Fund for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018 and Finance Act No. 38 of 1971. My comments and observations which I consider should be report to Parliament appear in this report.

I do not express an opinion on the accompanying financial statements of the Local Loan and Development Fund. Because of the significance of the matters discussed in the Basis for Disclaimer of Opinion section of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

1.2 Basis for Disclaimer of Opinion

I do not express an opinion based on the matters described in paragraph 1.5 of this report.

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my disclaimer of opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the fund's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the fund is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the fund.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

My responsibility is to conduct an audit of the Fund's financial statements in accordance with Sri Lanka Auditing Standards and to issue an auditor's report. However because of the matters described in the Basis for Disclaimer of Opinion section, I was not able to obtain sufficient appropriate audit evidences to provide a basis for an audit opinion on these financial statements.

1.5 Audit Observations on the preparation of Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

	Non Compliance with the reference to particular Standard	Management Comment	Recommendation
(a)	The cash flow statement had not been prepared in accordance with Sri Lanka Accounting Standard No. 07. The following observations are made in this regard. i. In the cash flow statement of the year under review, although the opening cash and cash equivalents balance was Rs.86,751,731, it was overstated by Rs.85,979,070 due to showing it as Rs.172,730,801. ii. When preparing the cash flow statement, differences were observed, that cash flow from operating activities understated by Rs.69,641,957, cash flow from investing activities understated by Rs.28,571,556 and cash flow from financing activities overstated by Rs.113,769,524.	Your observation is correct. The relevant errors will be rectified in the financial statements of the year 2023.	Financial statements should be prepared and presented in accordance with accounting standards.
(b)	In terms of paragraph 22 of Sri Lanka Accounting Standard No. 08, when a change in accounting policy is applied retrospectively, it should be presented in the financial statements in the year under review; however the comparative figures showing the restated values as at December 31, 2021 had not been	The financial statements related to the year 2022 will be restated and submitted along with the 2023 financial statements with all changes.	-Do-

	presented. Accordingly, previous year profit before tax of Rs.87,303,108 was not presented as a loss of Rs.661,570,406 and loans and receivables balance of Rs.3,454,569,841 was not presented as Rs.2,731,739,987 as the comparative figures in the financial statements.		
(c)	When adjusting the impairment in the financial statements of the year under review, an entity specific impairment model had not been developed according to the Sri Lanka Accounting Standard No. 09; instead a model developed for a profit oriented financial institution was adopted. Furthermore, when entering the data into the model used to calculate the impairment value, an individual age analysis which should be specially done for impairment, had not been done.	Although the model used for loan impairment is a model currently used by financial institutions, due to the small amount of debtor data in our institution and the ability of the institution to directly apply certain macroeconomic criteria, the debt impairment cost from 2021 to 2022 had been reduced by Rs.340,829,524. Hence it was decided in the meeting of the Board of Commissioners held on 26.05.2023 to seek the assistance of an experienced auditor to recalculate this impairment expense under the simplified method in terms of paragraph 5.5.15 of SLFRS 09.	The impairment should be adjusted in accordance with the accounting standards and approval by the Board of Commissioners should be obtained for that.
(d)	According to Paragraph 34 of Sri Lanka Accounting Standard No. 12, Deferred Tax Assets should be recognized for unused carry forward tax losses. However, for that the profit of the year was recognized and deferred tax assets had been calculated using the rate of 10 percent instead of 24 percent. Accordingly deferred tax asset on the carry forward tax losses had been understated by Rs.13,896,406.	Your observation is correct. By mistake, the balance on 01.01.2022 had been copied to the relevant calculation, and the indicated errors will be rectified in the accounts of the year 2023.	Financial statements should be prepared and presented in accordance with accounting standards.

(e)	In the year under review, an amount equal to Rs.1,235,838 incurred under the grant received from the United Nations Development Fund (UNDP) had not been recognized as income according to Sri Lanka Accounting Standard No. 20, instead a total receipt of Rs.12,500,000 had been recognized as other income.	Being a short-term project, all its income and expenses had been accounted on cash basis as revenue and expenditure in the relevant financial year.	-Do-

1.5.2 Accounting Deficiencies

	Audit Issue	Management Comment	Recommendation
(a)	Although the deferred tax asset as at December 31, 2022 was Rs.23,124,285, the same figure had been shown as Rs.7,856,456 in the statement of financial position, hence the deferred tax asset had been understated by Rs.15,267,829. Further the deferred tax income of the year should have been recognized as Rs.16,980,756 in the statement of comprehensive income had been recognized as Rs.1,712,928, hence the deferred tax income had been understated by Rs.15,267,828.	Your observation is correct. By mistake, the balance on 01.01.2022 had been copied to the relevant calculation, and the indicated errors will be rectified in the accounts of the year 2023.	Deferred tax income should be accurately calculated and included in the financial statements.
(b)	As the proportion of fixed deposit interest amounting Rs.14,015,293 related to the following year was included in the year under review. Accordingly, the other operating income and receivable investment interest in the year under review had been overstated by such amount.	Accepted. Onwards 2023, only the investment income relevant to the respective year will be accounted on accrual basis.	Accounting should be done accurately.
(c)	The income tax receivable amounting Rs.20,572,935 was brought forward to 01, January of the year under review had not been confirmed and then written off, instead transferred to the interest in suspense account of the loans of the Urban Development Low Income Housing Project (UDLIHP).	Instead of being transferred to the withholding tax receivable account, this amount of tax was mistakenly transferred to the UDLIHP - Interest in Suspense Account. Relevant corrections will be done in the year 2023.	-Do-

(d)	Although the interest receivable on loans for the year under review amounting to Rs.53,142,999 should be shown under loans and receivables, had been shown under other assets.	The balance shown in the Loan management software is only the interest income receivable for 2022. However, in addition to the interest income receivable for 2022, the due balance of the interest income receivable for 2021 is carried forward in the ledger, hence the difference arises.	-Do-
(e)	Income tax over-provision of Rs.2,319,635 had been adjusted to the accumulated fund rather than adjusting against the income tax expense of the year under review. Accordingly, the profit after tax of the year under review was understated by that amount.	Since the income tax adjustments related to the year 2021 had been made in relation to the accounts of the year 2021, when the payment is actually made the corresponding deficit or excess payment in the year 2022 should be adjusted in relation to the year 2021. Therefore it had been adjusted to the accumulated fund.	-Do-

1.5.3 Unreconciled Control Accounts or Records

	Item	As per Financial Statements Rs.	As per corresponding Record Rs.	Difference Rs.	Management Comment	Recommendation
(a)	Debt Capital Value	1,575,826,476	1,556,330,231	19,496,245	The reports generated by the Loan management software deduct the interest received in advance in the relevant year; however it is not done in the ledger accounts. Therefore, due to these reasons a comparison cannot be made between the balances in the interest in suspense account and the computer system balances.	System balances should be reconciled with ledger account balances.
(b)	Interest in suspense	709,251,218	504,723,323	204,527,895		

(c)	Interest income	124,270,999	123,950,039	320,960	An interest income received in 2021 related to 2022. Therefore, the interest amount in the advance account related to the year 2022 had been credited to the interest income accounts. However that amount in the loan management software had been offset against the opening balance of the respective debt account as a receipt in the year 2021.	Schedule balances should be compared to ledger account balances.
(d)	Loans and receivables	1,575,826,476	1,570,584,539 (As per the schedule)	5,241,937		
(e)	loans and receivables received in advance	2,848,299	2,502,558	345,741		
(f)	Loan balances pertaining to 04 local authorities	968,589,356 (As per loan management software)	635,069,504 (As per balance confirmation letters generated by the loan management software)	333,519,852	Although the loans disbursed in the year 2022 were recorded in the outstanding debt report as at 31, December 2022, due to an error in the computer system, these loan balances had not included in balance confirmations. It had been corrected.	The error in the computer system should be corrected.
(g)	Loans Receivables	2,675,720,913 (As per loan management software)	2,653,594,768 (As per confirmation)	22,126,145		

1.5.4 Inappropriate Estimation

Audit Issue	Management Comment	Recommendation
Although the balances of the ledger accounts were used to calculate the impairment value, the accuracy of the balances was not confirmed due to the existence of differences between the ledger accounts and the schedules, the non-submission of schedules regarding the interest in suspense accounts and the existence of differences between the	The financial statements of the year 2022 will be restated after making the relevant changes, and presented with all the amendments in 2023.	The balances shown in the ledger accounts, the schedule balances and the balances shown in the software should not be contradictory to each other.

balances of the software and the ledger accounts. Therefore accuracy of the impairment provision amounting to Rs.1,333,047,846 and gain on impairment amounting to Rs.340,829,524 could not be verified.

1.5.5 Documentary Evidences not made available for Audit

Item	Amount Rs.	Evidence not available	Management Comment	Recommendation
Interest in suspense accounts	709,251,218	Schedules	The documents relevant to these interests in suspense accounts had not been identified certainly at the time the accounts were prepared.	Schedules should be submitted for the balances shown in the ledger accounts.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
As at December 31, 2022, non-recoverable loan balance of Rs.283,009,856 remained outstanding for a period of 02 years to 38 years.	As at 31.12.2022, the non-recoverable loan balance was Rs.283 million, which had been reduced to Rs.278 million as on 30.09.2023. Efforts are being made to recover the loan amounting to Rs.106 million owed from Dambulla Municipal council, which is the highest among these non-recoverable loan balances. Further legal actions are being taken for the breach of loan agreements for other local government authorities.	Debt recovery should be expedited.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.573,679,095 and the corresponding profit in the preceding year amounted to Rs.67,821,845. Therefore an improvement amounting to Rs.505,857,250 of the financial result was observed. The main reasons for the improvement, are adjustment of gain on impairment in the year under review amounting Rs.340,829,524 and increase in other operating income by Rs.102,165,916.

3. Operational Review

3.1 Operational Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	A sum of Rs.426,600,000 had been approved by the fund for 09 credit projects during the year under review. However, disbursement for 02 projects amounting to Rs.51,800,000 was commenced and only Rs.17,090,000 had been released by the end of the year.	Since disbursements are based on the progress of the construction, such situation can be arisen.	Actions should be taken to speed up disbursement of loans.
(b)	Although a bonus of Rs.825,000 was paid based on the profit shown in the financial statements of the year 2021, if the adjustments to be made in the financial statements as per 1.5.1 (b) were made, it would be a loss, hence it was observed that the bonus payment was not worthy.	The Board of Commissioners has approved payment of bonus on 24, February 2023.	Bonuses shall be paid only on correctly adjusted profits and no bonuses shall be paid on losses.

3.2 Idle or underutilized Property, Plant and Equipment

Audit Issue	Management Comment	Recommendation
A sum of Rs.2,938,000 had been paid to establish computer software that covers 03 modules namely financial management module, credit management module and common module. Further Rs.1,762,800 had been paid for 03 years as annual maintenance fees by Rs.587,600 per each from the year 2020. However, except the credit management module, the financial management module and the common module were not in use.	The data had been entered to the financial management system up to 2021 but remains idle as accurate reports cannot be generated.	Actions should be taken to achieve intended purpose of the computer system.