

Local Loan and Development Fund - 2020

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Local Loan and Development Fund for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 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.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Fund as at 31 December 2020, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

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 qualified 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 Audit Scope (Auditor's Responsibility for the Audit of the Financial Statements)

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of

information to enable a continuous evaluation of the activities of the Fund, and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Fund has complied with applicable written law, or other general or special directions issued by the governing body of the Fund;
- Whether the Fund has performed according to its powers, functions and duties; and
- Whether the resources had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Audit Observations on the preparation of Financial Statements

1.5.1 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Management's Comment	Recommendation
PED Circular No.1/2015 dated 25 December 2015	Two Deputy Directors working in positions not entitled to transport allowances had been paid a sum of Rs.700,000 as transport allowance as Rs.17,500 per month from November 2017 to June 2019 without formal approval.	Payments have stopped by now	Circular instructions must be followed. Allowances paid without entitlement should be refunded.

1.5.2 Cash Management

Audit Observation	Management's Comment	Recommendation
A project account opened and maintained in the Central Bank of Sri Lanka for a perennial crop development project, was categorized under current accounts under the same name in the financial statement even after the completion of the project.	This account is a current account maintained by the Central Bank of Sri Lanka under the name of Local Loan and Development Fund. Although the perennial crop development project has been completed, the relevant loan repayments as well as the money so collected are still being paid to the Treasury and action will be taken to close the relevant account after the completion of the relevant debt collection and payments to the Treasury.	The Central Bank cannot maintain current accounts and this is a dollar account for a completed project. As the project is completed this dollar account should be settled and the balance transferred to an account of the fund.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs. 69,122,865 and the corresponding profit in the preceding year amounted to Rs. 69,222,613. Therefore, a deterioration amounting to Rs. 99,748 of the financial result was observed. The reason for the deterioration is the net interest income for the year under review decreased by Rs. 11,786,342 or 8.97 percent.

2.2 Trend Analysis of major Income and Expenditure items

Main Income/ Expenditure Source	2020	2019	Variance	Variance as a percentage
	Rs.	Rs.	Rs.	(%)
Interest Income	274,899,048	266,181,649	8,717,399	3.3
Other Operational Income	86,101,946	133,929,246	(47,827,300)	(35.7)
Interest Expenses	131,744,730	134,813,672	(3,068,942)	(2.3)
Net Amortization	115,998,584	153,588,013	(37,589,429)	(24.5)
Loan impairment	7,646,096	4,687,918	2,958,178	63.1

when comparing to the previous year financial statements, other operating income declined by Rs.47,827,300 as from Rs. 133,929,246 to Rs.86,101,946 and the main reason for the decline was due to lower deposit interest rates. Similarly, the previous year net amortization amount of Rs.153,588,013 had declined to Rs.115,998,584 during the year under review, by Rs.37,589,429 the main reason for the decline was decrease of the balances of assets and liabilities based for amortization.

Interest income had increased by Rs. 8,717,399, from Rs.266,181,649 in the previous year to Rs.274,899,048. This increase was due to the maintaining consistent loan recovery and the restructuring and recovery of several dormant loan projects.

3. Operational Review

3.1 Management Inefficiencies

Audit observation	Management's Comment	Recommendation
(a) Although a person with the required qualifications should be recruited as the Director of the Fund as per the recruitment procedure approved by the Department of Management Services on 08 April 2010, a permanent officer had not been appointed to this post. The performance of the institution was adversely affected due to the continuation of the acting basis for the post as the procedure for recruitment of a director on a secondary basis has not been amended and as per the letter No. PL / 4/11/1/2/7 dated 14 July 2019 of the Secretary to the Ministry of Home Affairs and Provincial Councils and Local Government, the Director (Planning) of the Provincial Councils and Local Government Division of the Ministry was already working as the Project Director of the Regional Development Project, a development project funded by the World Bank.	The Commission has been informed about this and a paper has been submitted to the Commission on this subject to be held on 30 June 2021.	Vacancies should be filled as long-term attachment to acting positions will adversely affect the performance of the organization.
(b) Although the Board of Commissioners has the power to appoint staff in terms of Section 3 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, Without the approval of the Board of Commissioners, the then Secretary to the relevant Ministry had appointed an officer in the Accounting Service to cover / perform duties of the Director of the Institute. Further, in the years 2015 and 2016, a total of Rs.1,244,905 was paid to that officer as acting salary of Rs.382,056 contrary to Section 12:5:4 and Section 12:8 of	All possible steps have been taken by the Institute in this regard and the matter has been discussed in the Audit and Management Committee of the Institute and the Ministry and in the Board of Commissioners. Finally, reminder letters have been sent to recover the money. However, at the Commission meeting held on 25 February 2021, it was decided to inform the Secretary of the Public Service Commission, the relevant disciplinary authority,	Action should be taken to recover the acting salary, transport allowance and fuel allowance paid contrary to the rules and regulations.

Chapter VII of the Establishments Code of the Democratic Socialist Republic of Sri Lanka and as transport allowance of Rs.522,000 and fuel allowance of Rs.340,849 contrary to paragraph 5 of Public Enterprise Circular No. PED / 50 dated 28 July 2008 and paragraph 3.7 of Public Enterprise Circular No. PED 1/2015 dated 25th May 2015.

to conduct a formal disciplinary inquiry into the relevant officer, and the required information was communicated in writing to the Public Service Commission on 08 April 2021.

3.2 Operational Inefficiencies

Audit observation	Management's Comment	Recommendation
(a) Although the fund had approved 15 loan project with a total value of Rs.268,627,600 during the year under review, out of this, only 55.26 percent or Rs.20,780,000 had been issued by the end of the year after the commencement of payments on two loan projects with a total value of Rs.37,600,000.	This situation has been shown as the loan is released on the progress of the construction.	Since the main function of the fund is to provide loans to local authorities, action should be taken to issue approved loans expeditiously.
(b) Although the Fund approved 139 loan projects from 2014 to 2020, 48 of them were rejected by local authorities.	The current situation in the country has led to the blocking of vehicle purchases as per Budget Circular No. 03/2018.	Since the main function of the fund is to provide loans to local authorities, action should be taken to issue approved loans expeditiously
(c) As at 31 December 2020, 18 loan projects with a total value of Rs. 419,177,427 were listed as non-performing loans and the non-payment period ranged from 2½ years to 21 years. Further, since loans amounting to Rs.260,624,776 had been restructured, loans amounting to Rs. 158,552,651 had not been recovered.	The fund did its best to recover the loans and it has been difficult to recover from six projects.	Loan recovery procedures should be carried out efficiently
(d) Although 33 loan projects with a total value of Rs. 1,916,490,000 have been approved in 2019, Of those projects, 19 loan projects with a total value of Rs.991,690,000 or 57 percent had been canceled by 2020.	Your point is correct. A systematic procedure is being prepared for this.	The credit approval process should be reviewed and revised.

3.3 Transactions of Contentious Nature

Audit Observation	Management's Comment	Recommendation
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<p>A sum of Rs.200,000 had been paid in advance without any security for the preparation of manuals for the Fund by obtaining bids under the price quotation scheme without conducting a study on the need for the manual and without setting the desired targets and standards. The remaining amount of Rs.100,000 of the 50% of the amount due had been paid subject to the cover approval of the Governing Body without an evaluation of the quantity and quality of the manuals.</p>	<p>The Activity Manual of this Institute was prepared on the recommendation of the Final Report issued in 2017 in accordance with the Institutional Restructuring Program, which has been in operation since 2016. Accordingly, this work has been included in the 2018 Action Plan of the Institute and the activities of the aforesaid action plan and the relevant Heads of Expenditure were approved by the Board of Commissioners on 15 December 2017 on the recommendations of the Audit and Management Committee held on 05 December 2017. Accordingly, steps have been taken to prepare the Financial Manual under the Restructuring of the Financial Division of the Institute and the Human Resources and Administrative Handbooks under the Restructuring of the Human Resources and Administration Division included in the Action Plan and Terms of Reference (TOR) were prepared for this purpose and these tasks were assigned to the lowest bidder. A committee was appointed by the Chairman on 04 April 2019 to examine the quality and adequacy of these manuals and Upon receipt of its report, action will be taken to obtain the necessary approval for these manuals, including any necessary changes, and to then implement them.</p>	<p>Must comply with the Procurement Circular</p>

4. Accountability and Good Governance

4.1 Internal Audit

Audit Observation	Management's Comment	Recommendation
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An internal auditor had not been appointed for the Fund and no internal audit had been conducted even by the Line Ministry.	The Line Ministry has made arrangements to conduct an internal audit.	It is best to appoint an internal auditor to periodically install the systems and check that they are working properly.

4.2 Audit Committee

Audit Observation	Management's Comment	Recommendation
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Although four meetings of the Audit and Management Committee were to be held for the year, only one meeting was held.	The Audit and Management Committee meeting could not be held as scheduled due to the Covid 19 epidemic.	The activities of the fund should be properly maintained.

4.3 Sustainable Development Goals

Audit Observation	Management's Comment	Recommendation
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According to the United Nations 2030 Agenda for Sustainable Development, the Fund was not aware of how it should act in relation to its scope of work for the year under review. As a result, the Sustainable Development Goals, targets and milestones that fall within the scope of the Fund and the indicators for measuring target achievement have not been identified.	Not answered.	Management needs to focus on identifying sustainable development goals and assigning responsibilities to specific officials.