

## **Local Loan and Development Fund - 2021**

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### **1. Financial Statements**

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#### **1.1 Qualified Opinion**

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The audit of the financial statements of the Local Loan and Development Fund for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 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, except for the effects of the matters described in paragraph 1.5 of this report, the financial statements give a true and fair view of the financial position of the fund as at 31 December 2021, 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 Qualified Opinion**

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I expressed qualified opinion 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 qualified opinion.

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

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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 stability 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 Sub 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 Responsibility for the Audit of the Financial Statements**

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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 scepticism 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 of the fund 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 Internal Control over the preparation of financial statements**

| <b>Audit Observation</b>   | <b>Management's Comment</b>                | <b>Recommendation</b>                        |
|--|--|--|
| (a) A sum of Rs.632,710 was debited to the LLDF-PS Loan Interest Income account by a single journal entry.   | Correctly recorded in the computer system. | Account books should be properly maintained. |
| (b) By crediting a sum of Rs.4,484,631 instead of the interest receivable amount of Rs.3,801,359 to the LLDF-PS loan interest income account, a sum of Rs.683,272 was recorded more than the value of the journal voucher. | Do   | Do   |
| (c) LGIIP Loan Interest Income account was debited by Rs.1,734,667 by a single journal entry.  | Do   | Do   |
| (d) Instead of the interest receivable of Rs.7,444,668 to be credited to the LGIIP loan interest income account, a sum of Rs.9,420,913 had been credited and the account had been over-credited by Rs.1,976,246.           | Do   | Do   |
| (e) LGIIP Loan Interest in suspense account was debited by Rs.241,578 by a single journal entry.   | Do   | Do   |

- (f) Instead of the interest receivable of Rs.7,439,034 to be credited to the UDLIHP loan interest income account, a sum of Rs.7,714,845 had been credited and the account had been over-credited by Rs.275,811. Do Do

### 1.5.2 Non-Compliance with Sri Lanka Accounting Standard

| <b>Non Compliance with the reference to particular Standard</b>   | <b>Management Comment</b>                        | <b>Recommendation</b>  |
|---|--|--|
| <b>Sri Lanka Accounting Standard No 07</b>  |  |  |
| (a) In calculating the net cash flow from operating activities in the cash flow statement, the LGIIP grant amortization (Grant amortization) value of Rs.4,197,514 was adjusted (deducted) twice.   | Accepted.<br>Will be corrected in the year 2022. | Financial statements should be prepared according to accounting standards. |
| (b) It was observed that the value identified in the income statement as investment income for the year which was Rs. 57,990,871 was entered as investment income received under investment activities and it was not investment income received in cash. | Accepted.<br>Will be corrected in the year 2022  | Financial statements should be prepared according to accounting standards. |

### 1.5.3 Accounting Policies

| <b>Audit Observation</b>  | <b>Management Comment</b>           | <b>Recommendation</b>                           |
|---|-------------------------------------|---|
| a. The amount of Rs.436,800 paid in the year 2022 for the printing of the 2020 annual reports was not recognized as an expense in the year 2021 and was not accounted for as an accrued expense. As a result, the value of the year's expenses and other liabilities was understated by Rs.436,800. | Will be corrected in the year 2022. | The Institute's accounting should be corrected. |

#### 1.5.4 Unreconciled Control Accounts or Records

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| Item                     | as per<br>Financial<br>Statements<br>Rs. | As per<br>corresponding<br>Record<br>Rs. | Differenc<br>e Rs. | Management<br>Comment | Recommendation   |
|--------------------------|--|--|--------------------|-----------------------|--|
| -----                    | -----                                    | -----                                    | -----              | -----                 | -----  |
| a. Loans and receivables | 434,011,460                              | 432,899,948                              | 1,111,512          | Corrected.            | Financial statements should be prepared on accurate values after prepared the reconciliation statements. |

#### 1.5.5 Inappropriate evaluation or estimation

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| Audit Observation   | Management Comment   | Recommendation  |
|---|--|---|
| -----   | -----  | -----   |
| <p><b>a. Provisions for Loan Impairment.</b><br/>There was a difference of Rs.95,240,649 between the balances used in adjusting the provisions for impairment and the balances obtained from the credit management software. Accordingly, the correct impairment expenses calculation was Rs.17,553,807. Due to the impairment expense accounted for the year under review being Rs.9,956,340, the profit and loan and receivable value of the year was overstated by Rs.7,597,467.</p>   | <p>Changes were corrected. Debtor's ledger balances are used for provisions for loan impairment.</p> | <p>As the loan impairment expenses affects the operating profit of the year, measures should be taken to ensure that the correct calculations have been made.</p> |
| <p><b>b. Provision for Differed Tax</b><br/>In adjusting the profit to identify the deferred tax asset, instead of the impairment expense of Rs.9,956,340 accounted for the year, a value of Rs.34,694,072 was taken and although the income tax rate of the year was 28 per cent, a tax rate of 10 per cent was used to adjust the deferred tax. Due to these facts, in the statement of financial position, the deferred tax assets were understated by Rs.5,223,916 and an expense of Rs.3,400,207 was shown instead of the deferred tax income.</p> | <p>Will be corrected in the year 2022.</p>   | <p>Actions must be taken to ensure that correct calculations have been made.</p>  |

**c Provision for Gratuity**

Although it had been mentioned that 11 per cent was used as the discount factor in the Actuarial valuation report for calculating the value of gratuity expenses, interest cost had been calculated based on 7.6 per cent as the discount factor. Accordingly the gratuity expense was understated by Rs.176,986. Due to this, the actuarial loss in other comprehensive income was also understated by the same amount.

Will be corrected in the year 2022.

Accounting should be done correctly.

**1.5.6 Documentary Evidences not made available for Audit**

| Item Available        | Amount     | Evidence not made available  | Management Comment                                  | Recommendation  |
|-----------------------|------------|--|---|---|
| Rs.                   |            |  |   |   |
| Income tax receivable | 20,572,467 | a) Documents that such income tax has been paid to the Inland Revenue Department.<br>b) A confirmation letter from the Inland Revenue Department, that the amount will be refunded or offset against future taxes. | The previous year's income tax return was submitted | Written evidence should be submitted to the audit to verify the relevant balance. |

**1.6 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. |

## 2. Financial Review

### 2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.67,821,845 and the corresponding profit in the preceding year amounted to Rs. 69,122,865. Therefore, a deterioration amounting to Rs. 1,301,020 of the financial result was observed. The reason for the deterioration is decrease in the other operating income for the year under review by Rs. 22,667,688 or 35.73 per cent.

#### 2.1 Trend Analysis of major Income and Expenditure items

| Main Income/<br>Source        | 2021        | 2020        | Variance     | Variance as a<br>percentage |
|-------------------------------|-------------|-------------|--------------|-----------------------------|
|                               | Rs.         | Rs.         | Rs.          | (%)                         |
| Other Operational Income      | 63,434,258  | 86,101,946  | (22,667,661) | (35.73%)                    |
| Interest Expenses             | 126,304,798 | 131,744,370 | (5,439,932)  | (4.31%)                     |
| Staff Expenses                | 26,846,049  | 26,614,719  | 231,330      | 8.60%                       |
| Amortization                  | 74,910,206  | 115,998,584 | (41,088,378) | (54.85%)                    |
| Other Operational Expenditure | 11,900,825  | 10,051,521  | 1,849,304    | 15.54%                      |
| Loan impairment               | 9,956,340   | 7,646,096   | 2,310,244    | 23.20%                      |

When comparing to the previous year financial statements, amortization amount of Rs.115,998,584 had declined to Rs.74,910,206 and the main reason for the decline was decrease of the balances of assets and liabilities based for amortization. The increase in default of loan instalments had led to the increase in loan impairment from Rs.7,646,096 in the previous year to Rs.9,310,244 in the year under review. If the loan impairment was correctly calculated and accounted for, the impairment expense should have increased by Rs. 7,597,467 in the year under review, and accordingly, the profit for the year should have decreased by the same amount.

There was a slight increase in the interest income from Rs.274,899,048 in the previous year to Rs.274,545,152 and this was due to trying to maintain a stable collection of premiums and interest from the local government authorities even under the travel restrictions imposed by the government.

### 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 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. | 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, 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. Accordingly, the Director General of the Ministry | Vacancies should be filled promptly.  |



of Finance has been appointed on 02 September 2021 for a preliminary investigation.

## 2.2 Operational Inefficiencies

| Audit Observation  | Management's Comment  | Recommendation   |
|--|---|--|
| <p>(a) Although the fund had approved 19 loan project with a total value of Rs.1,095,384,000 during the year under review, out of this, only 38.6 per cent or Rs.422,775,000 had been issued by the end of the year after the commencement of payments on 06 loan projects with a total value of Rs.942,748,000.</p> <p>Among these, due to the approval of a loan of Rs.800,000,000 to the Kurunegala Municipal Council and the payment of Rs.375,850,000 out of it, aforesaid progress could have been recorded.</p> | <p>This situation has been shown as the loan is released on the progress of the construction.</p>         | <p>Since the main function of the fund is to provide loans to local authorities, action should be taken to issue approved loans expeditiously.</p> |
| <p>(b) As at 31 December 2021, 18 loan projects with a total value of Rs.280,723,585 were listed as non-performing loans and the non-payment period ranged from 2½ years to 23 years. Further, since loans amounting to Rs.18,000,816 had been restructured, loans amounting to Rs.11,002,573 had not been recovered.</p>  | <p>The fund did its best to recover the loans and it has been difficult to recover from six projects.</p> | <p>Loan recovery procedures should be carried out efficiently</p>  |

## 2.3 Transactions of Contentious Nature

| Audit Observation  | Management's Comment  | Recommendation                                   |
|--|---|--|
| <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%</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</p> | <p>Must comply with the Procurement Circular</p> |

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.

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.

**4. Accountability and Good Governance**

**4.2 Board of Commissioners Meeting**

| <b>Audit Observation</b>   | <b>Management’s Comment</b>   | <b>Recommendation</b>                                     |
|--|---|---|
| Although 12 meetings of the Board of Commissioners should be held in a year as once a month, only 04 meetings were held. | The Board of Commissioners meetings could not be held as scheduled due to the Covid 19 epidemic | The activities of the fund should be properly maintained. |

**4.2 Audit and Management Committee**

| <b>Audit Observation</b>  | <b>Management’s Comment</b>   | <b>Recommendation</b>                                     |
|---|---|---|
| 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

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#### **Audit Observation**

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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.

#### **Management's Comment**

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Not answered.

#### **Recommendation**

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Management needs to focus on identifying sustainable development goals and assigning responsibilities to specific officials.