Housing Development Finance Corporation Bank of Sri Lanka - 2021

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1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Housing Development Finance Corporation Bank(“Bank’’) for the year ended 31 December 2021comprising the statement of financial position as at 31 December 2021and the statement of income and the statement of comprehensive income, statement of changes in equity and statement of cash flow 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 of the Bank give a true and fair view of the financial position of the bank as at 31 December 2021, and of their financial performance and 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 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 Bank’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 Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Bank 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 Bank.

1.4 Audit Scope

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 Bank'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 Bank'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 tothe 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 Bank 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 Bank, and whether such systems, procedures, books, records and other documents are in effective operation;

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

1.5 Accounts Receivable and Payable

1.5.1 Payables

	Audit Issue	Management Comment	Recommendation
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(i)	Three GL account balances amounting to Rs.8.8 million consist of same amount for more than five years which have been included in other liabilities as at 31 December 2021.	This will be rectified in future.	Necessary actions need to be taken to clear all long outstanding balances in the future.
(ii)	A sum of Rs.13.6 million had been remained since 2016 in the Police Housing Development Fund account (1310180001) without taking necessary action to settle this fund.	Action will be taken in 2022.	If the loan scheme no longer exists, Actions need to be taken to settle the relevant fund.
(iii)	The balance of Rs.4.2 million in the Supplier Payable Account (1310210012) for more than one year had not been cleared even until the date of audit on 27 April 2022.	This will be rectified in 2022.	Actions need to be taken to clear this balance as soon as possible.

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

	Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
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i.	Section 16(2) Part IV of Housing Development Finance Corporation Act, No 7 of 1997	Issued capital of the bank should be Rs.1,000 million. However, stated capital of the bank as at 31 December 2021 was Rs.962 million. The bank had failed to fulfill the balance capital.	The concept of issued capital is no more in the Company Act. The Company's Act new definition stated capital which includes reserve too.	Necessary action need to be taken to comply with the relevant act.

ii. Banking Act Direction No 05 of 2017 dated 26 October 2017 section 02 of the Central Bank	Minimum Capital of the bank should be Rs.7,500 million commencing from 31 December 2020, and further it was extended up to 31 December 2023. However, Bank was able to raise only up Rs.6,435 million of capital as at the end of the year 2021.	The Regulated capital as at 31st December 2021, is Rs.6,717 million and the shortfall is Rs.783Mn which is expected be filled by 31 December 2023.	Necessary action need to be taken to comply with the relevant direction.
iii. **Direction and Guideline issued by CBSL**			
a) Direction D 2.9 (a) 7 of Banking Act Direction No 02 of 2014 dated 25.06.2014 on amendment to the Banking act direction No 07 dated 05.10.2011 on IRM Frame work for the licensed banking	All banks should implement the Baseline Security Standard for information security management with effect from 01 July 2015. However, bank has failed to implement aforesaid standard. Even though the IT Department of the bank has developed the BSS policies, the bank has still failed to implement the same within the entire banking network. Said direction had given 95 Baseline Security Standard (BSS) control objectives and out of which only 45 control objectives have been completed by the bank.	Bank IS team is in the process of implementing the BSS control requirements. While progressing, high cost required to apply the control and existing building structure have become challenges. However, we have been in the process of achieving the required level of controls to comply with the direction.	Need to follow cited Direction
b) Section 15 (7) of the Pawning Direction issued by CBSL	If an article is sold for an amount exceeding the money lent on the security of that article together with interest thereon, the Pawnee shall forthwith give notice to the pawner of that article by registered post to the address stated in the pledge book. However, such notices have not successfully been given to the pawners by the bank. As a result of that excess money amounted to Rs.1.5 million received from pawning auction had been remained more than one year.	This will be rectified in 2022.	Need to follow cited Direction

c) Section 25 of the CBSL Guidelines no 02/2021 and dated 20 July 2021	All financial institutions (FI) are required to issue internal operational guideline on placement, functionality, monitoring, record keeping, system maintenance and administration, and include it as a part of AML/CFT policy as well with the approval of Board of Directors (BOD). However, the bank had failed to fulfill this requirement for the financial year under review.	Internal operational guideline will be prepared and submitted to the board before 31.12.2022	Need to follow cited Direction
iv. **Loan Recovery Manual**			
a) Section 4.1.1	Total outstanding balance of loans (capital +interest) categorized under Vested Properties as at 31 December 2021 was Rs.380 million. Out of that 96 Vested Properties amounting to Rs.23.5 million were remained over five years period.	The following factors have contributed to the delay in the sales of the above properties acquired by the bank, • Boundaries are not clear • Water supply not available • Ejectment cases filed (Encroached/occupied) • No prospective buyers to purchase the lands • Due to the poor demand as a result of the irregular shape of the land	Land value of the property should be properly evaluated before granting the Mortgage loans and steps should be taken to recover the outstanding balance.
b) Section 4.1.5	Revaluation on Vested Properties should be done at least in every 2 years by an Internal valuer or 4 years by an External Valuer. Contrary to that 28 Vested Properties bearing capital and interest outstanding amount of Rs.4, 024,668had not been revalued by the bank.	The bank has decided to call a revaluation report only about 6 months before the tender call.	Necessary action need to be taken to amend the relevant manual.

c)	Section 4.1.9	The excess money amounted to Rs.5,9 million appeared in the Advanced Received on auction Properties General Ledger more than one year without repaying to the respective customers.	**LedgerAccount (1310170007)** When we sell the vested property, we have sent a memo to loan admin division to transfer the money to fully settle the loan. Advanced tender payment Rs. 10000/= to be refunded to the relevant customers. We have already sent letters to customers and informing collect their refundable amount, and also we inform to the relevant branches to follow up customers. We refunded some excess balance and some customers have still not responded for the letter. Therefore we have informed to branch managers to follow this cases. **Ledger Account (1310170018)** From January 2021 to December 2021 no transactions were made under this ledger Number.	Action need to be taken to repay the excess money to the respective customers.

v. **Internal Circulars**

a)	Internal Circular No: GCL/2017/ 223 and dated 01 March 2017	Inter–System-GL-CBS LMS (1600100001) and Cheque in hands (1331100001) should be zero as at end of the day. However, credit balance of Rs.4 million and Rs.6.7 million respectively remained in the accounts without clearing.	**1331100001** Represents the cheque deposited but not realized which is cannot be zero. **1600100001** Action will be taken rectify in 2022.	Action need to be taken to correct this kind of situation.

1.7 Non -compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
As per the Inland Revenue Act, No. 10 of 2021, WHT on interest, dividends, rent, and service payments to residents is abolished with effect from 1 January 2020. However, bank has deducted Rs.1.1 million WHT on interest.	Due to the non – amendment of CIF by the Branches, from January 2020, WHT has been deducted from such accounts and those deducted values are now being reconciled to refund to respective customers.	Necessary action need to be taken to comply with the relevant act and deducted WHT to be refunded to respective customers.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.547 million and the corresponding profit in the preceding year amounted to Rs.708 million. Therefore a deterioration amounting to Rs.161 million of the financial result was observed. The main reason for the deterioration are the decrease of Interest Income by Rs.844 million, increased personal cost by Rs.213 million and other expenses by Rs.62 million.

2.2 Trend Analysis of major Income and Expenditure items

Items	2021 Rs. Million	2020 Rs. Million	Percentage of Change over previous year
Interest Income	6,612	7,457	(11.33)
Interest Expenses	(3,556)	(4,475)	(20.53)
Net Interest Income	**3,056**	**2,981**	**2.52**
Net Fee and Commission Income	343	303	13.20
Other Operating Income (Net)	49	97	(49.48)
Total Operating Income	**3,448**	**3,381**	**1.98**
Impairment Charges for Loans & Other Losses	(296)	(326)	9.20
Net Operating Income	**3,152**	**3,055**	**3.17**
Staff Cost	1,387	1,174	18.14

Other Expenses	566	499	13.43
Operating Profit Before Value Added Tax	**1199**	**1,381**	**(13.18)**
VAT on Financial Services	320	313	2.24
Tax Expenses	331	360	(8.05)
Profit for the year	**547**	**708**	**(22.74)**

2.3 Ratio Analysis

2.3.1 According to the information made available, some of the important ratios of the Bank for the year under review and the preceding year is as follows.

Name of Ratio	Central Bank Statistics *(Provisional)	2021	2020
Profitability Ratios			
(i) Net Profit Ratio (Percentage)		7.81	9.01
(ii) Net Interest Income/ Interest Income (Percentage)		46.22	39.98
(iii) Interest cost to Interest Income (Percentage)		53.78	60.02
(iv) Return on Average Assets (Percentage)	1.7	0.88	1.21
(v) Return On average Share Holders Fund (Percentage)	1.3	9.02	12.99
Capital Adequacy Ratios			
Tier I (Minimum 8.5%)	12.0	22.38	20.20
Tier II (Minimum 12.5%)	14.6	23.02	20.67
Liquid Assets Ratios			
Liquid Assets Ratio	52.8	26.6	37.20

Other Ratios(In Rupees)

Earnings Per Share	8.46	10.94
Net Assets Per Share	98.18	89.35
Market Value Per Share as at end of the Year	30.5	36.2

* Source: -Central Bank Financial Sector Statistics 2021-Table 4.2 (Provisional Data)

The following observations are made in this regard.

(a) Net Profit Ratio had been decreased from 9.01 per cent (2020) to 7.81 per cent (2021) and Net Interest Income had been increased from39.98per cent (2020) to 46.22per cent (2021) in the year under review. The increase in interest income and the increase in personal and other expenses had been the reason for the related changes.

(b) Return on Average Assets and Return on Average Share Holders Fund had been decreased from 1.21per cent (2020) to 0.88 per cent (2021)and 12.99 per cent (2020) to 9.02 per cent (2021)respectively in the year under review.

(c) Earnings per Share hadbeen decreased from 10.94per cent (2020) to 8.46per cent (2021) and Market Value per Share as at end of the year had been decreased from 36.2 per cent (2020) to 30.5per cent (2021) in the year under review.

2.4 Maturity Analysis

Audit Issue	Management Comment	Recommendation
Analysis of Financial Assets and Financial Liabilities by remaining contractual maturities as at 31 December 2021 revealed that Financial Liabilities for months 3-12 was far in excess over total assets, and the liquidity gap was Rs.12, 860 million.	The maturities of the Assets in 3-12 months are below the respective liabilities as most of the Liabilities have been financed by Deposits. This is the nature of the banking business.	Take necessary steps to minimize the maturity gap in future.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
i. Sale of Vested Properties It was observed that the Bank had sold 20 Vested	All the above properties have been sold in accordance with the bank's procedure and with the approval of the	Suitable actions need to be taken to prevent this type of

Properties during the year 2021 and 2022 January which had recoverable balances of Rs.16.2 million and incurred a loss of Rs.5.8 million at the time of selling.	board of directors in case of selling the property at a lower price than the valuation report that existed at that time or at a lower value than the dues calculations. Due to the location of the land and various difficulties the bank had to sell at lower prices to get the money tied up in these assets released.	situations in the future.
ii. Fraudulent loans Seven fraudulent loans amounting to Rs.8 million were granted to Sumithra Hasalaka (Pvt) Ltd by the Ampara Branch and subsequently it had been transferred to non performing category. The outstanding balance as at 31 December 2021 was Rs.11 million.	i) 801650000408 Legal action has been instituted. Case has been filed on 26.06.2020. Summons to be served to 1st, 2nd and 3rd defendant. ii) Legal action has been instituted. Case has been filed on 20.04.2022. Next hearing date is 30.09.2022 in relation to following loans 801650000426 801650000427 801650000493 801650000502 801650000503 801650000504	Take necessary action to prevent this type of situations in the future and follow recovery action to recover outstanding balance.
iii. The robberies taken place at Matara Branch In September and November 2021, two robberies have been occurred at the Matara branch. The robbers has attempted twice in the same year and 1st attempt was unsuccessful. However, in the second attempt they were able to steal cash and other things including the Digital Video Recorder of the branch. The loss of cash in safe was Rs.3 million and the insurance claim was received Rs.2.8 million.	In the insurance industry, there is a practice of deducting a certain percentage or amount from the insured claim. In HDFC compensation cover it is 10% or a minimum Rs.10,000. Therefore, the bank has received Rs.2,768,327 after deducting 10% of the claim.	Take necessary action to prevent this type of situations in the future.

Therefore, it has created a loss of Rs.307,591 to the bank.		

3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
i) Investment in debentures in MTD Walkers PLC The Bank had invested Rs.50.95 million in debenture at the rate of 11.75 percent of MTD Walkers PLC on 01 October 2018 with one-year maturity period. However, the capital of Rs.50.95 million and the interest of Rs.13.53 million had not been repaid by the company as at the date of audit. Further, issuing company's rating had been downgraded during 2019 and negative financial position was reported in 2018 and 2019 respectively. Even though, an amount of Rs.13.55 million had been accounted as interest receivable from the aforesaid Debentures in financial statements, recoverability of this receivable amount is questionable. However, additional impairment of Rs.12.02 million had been made in 2021 for debenture interest receivable from the company.	We have made adjustment in impairment while the actions will be taken in 2022 for recovering this.	Suitable decisions need to be taken not occur this type of situations in the future and action need to be taken to collect investment value and remaining interest from MTD Walkers PLC.
ii) Investment Property Ownership of the investment property valued at Rs.801 million and located in the premises of the building material corporation, Sri Sangaraja Mawatha, Colombo 13, has been transferred to the bank on 31 December 2008. However, the vacant possession of the land was not handed over to the bank by Building Material Corporation (BMC). It was noted that the bank was trying to obtain vacant possession of the land since 2008. By the letter dated 10 February 2022, Lanka building Material Corporation,	Actions were already taken for either recovering of fair value or take the possession of the land in 2022.	Immediate action need to be taken to obtain the vacant possession of the land to the bank.

expressed their willingness to repurchase the land from the Bank and has offered to start proceedings by paying Rs.500,000 per month. Following facts had been considered by the board paper of 259 board meeting held on 23February 2022, to allow two months for BMC to make arrangements with Government

- Treasury to issue Treasury Bonds in favor of the Bank for the full value of the land in lieu of cash payment.
- The absolute ownership of the land will be transferred only after finalizing process.
- If the BMC failed to implement the Bank's proposal, execute the writ and possess the land.

However, the vacant possession of the land was not yet obtained.

iii) Very Important Professionals

As per the circular No .GCL/2016/210 dated 28 September 2016 the bank had introduced housing loan facilities to Very Important Professionals (VIP) and 140 loans amounting to Rs.282.99 million had been granted under this scheme. 34 number of loans amounting to Rs.69.7 million (24.63 per cent) had been categorized as non-performing as at 31 December 2021. However, there was no any secondary recovery option to the bank due to the unavailability of security.	This scheme (VIP) has been withdrawn. No new loans are granted under this scheme. Presently legal action has been taken for 10 facilities and terms of settlement obtained for 2 facilities. 37 facilities are in performing status and 37 in nonperforming as at end of August 2022. Branches have been advised to follow up on recovery and the progress is monitored during branch recovery meetings held.	Suitable actions need to be taken to prevent this type of situations in the future.

3.3 Borrowings of the bank

	2022 Budgeted Rs Million	2021 Rs Million	2020 Rs. Million	2019 Rs. Million	2018 Rs. Million	2017 Rs. Million
Total Borrowings	7,021	5090	5,542	6,866	6,653	7,917
Shareholders' Funds	7,019	6354	5,782	5,119	4,757	4,232
Debt to Equity Ratio	1	0.80	0.96	1.34	1.40	1.87
Leverage Ratio (Gearing Ratio)	50%	44%	49%	57%	58%	65%
Interest Covering Ratio	2.6	3.0	2.6	2.1	1.8	1.6

The Debt Equity Ratio of the year under review was 0.8 which include low gearing situation. Bank's gearing ratio had been reduced throughout the last five years by making a favorable situation for the bank. Due to the reason that the bank had settled its debt capital during that last five years, Interest Cover Ratio has increased 14.97 per cent when compared with previous years.

3.4 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
A. Loans and Advances – Performing & Non Performing Loans(Excluding EPF and Leasing)		
i) The total capital outstanding balance of loans and advances as at 31 December 2021 was Rs.27,131 million and non-performing loans and advances as at that date was Rs.5,116 million and it represents 18.86 per cent of total capital outstanding balance of loans and advances. Further, it was observed that Rs.2,101 million of loans (7.74 per cent of total capital outstanding) had been categorized under watch status which had a risk of subsequently become non performing status.	Bank's NPL ratio excluding EPF loans is maintained at 18%- 20% for the last 3 to 5 years. But very recently Bank has taken many steps to bring down NPL ratio, such as all disbursements are approved centrally after checking all documents and in case of Guarantor Loans disbursements are released only after salary is transferred to HDFC Bank. Further Recovery Department has been strengthen By Appointing a	Need to maintain non-performing loans and advances ratio according to sector ratio.

The total outstanding balance of 67 Corporate Loans as at 31 December 2021 was Rs.1,378 million. Out of that Rs.618 million (10 loans) had been converted to non-performing category as at the 31 December 2021. Further, it was observed that Rs.22 million of the aforesaid loans had been categorized under watch status which had a risk of subsequently become Non performing status.	Chief Manger – recovery and Once a week recovery progress meetings are conducted by recovery Division with the Support of Legal Division and with the intention of reducing the future NPL Ratio. During the last three years approved Loans NPL ratio is maintained at 6%- 7.5%. The total responsibility of handling recoveries of Corporate Loans has been assigned to Corporate Loan and Development Finance Division by the Management with the intention of reducing NPL of Corporate Loans as a special task. They can get the Support of Recovery Division and Legal when required.	
ii) Loans disbursed during the year 2021 and transferred to Non- performing category. 19,980 number of loans amounting toRs.11,446 million were granted during the year 2021 and out of that 2,906 numbers of loans amounting to Rs.1,183 million (10per cent of loan granted during the year 2021) were transferred to Non-performing category	This is due to the prevailing situation of the country. By giving concession to customers' bank managed to maintain the ratio at 18 %. In case of EPF Loans Normal trend is customers are taking this loan to use their EPF Balance with the CBSL and not to pay the installments. This practice can't be changed even customers are educated by the Bank to safe guard their EPF balance at retirement.	Customer's income sauces should be evaluated properly before granting loans and follow up steps should be taken to recover the outstanding balance.
iii) Loan granted to Government Institutions The Bank has granted two loan Facilities to two government institutions ie. State Engineering Corporation (SEC) on behalf of	• Considering the cash flow difficulties faced by SD&CC we will accept the payment of Rs 200,000/= until the end of September 2022 and	Proper actions need to be taken to recover those loans

National Equipment and Machinery Organization (NEMO) and State Development and Construction Corporation (SD&CC) amounting to Rs.71.40 million and Rs.84 million respectively. Both of these entities have not performed as expected at the time of granting the loan facilities and currently both loans had been categorized under non-performing category and thetotal outstanding without recovering as at 31 December 2021 amounting to Rs.118 million. The bank has granted the aforesaid two loans without evaluating the credit worthiness of the customer.

thereafter SD&CC is required to make sufficient deposits to cover the interest component of both facilities from October 2022 onward.
After monitoring the progress of repayment up to December 2022 and also the progress of receiving payment through RDA, Bank intends to take alternative recovery action in this regard.

- At the 232 Board meeting decided to proceed legal action and accordingly litigation activities are in progress. The court has instructed to two parties to submit a settlement plan. We have discussed this matter with the heads of both organization and (SEC & HDFC) and SEC has failed to submit a repayment plan to the Bank.
  Answer of the State Engineering Corporation (SEC)is due on the 1st of September 2022. This is the final date given to file answer. If they file, the answer to this case will be fixed for pre trial.
  If the Court does not grant another date to State Eng. Corp. to file answer we can move for expartetrial.

iv) Loan Number 110730000001 The bank had granted an amount of Rs.350 million to Bimputh Finance PLC on 18 July 2018. This loan was in the performing loan category as at 31 December 2021 and currently it was transferred to non-performing category. Further, it was observed that Fitch rating of Bimputh Finance PLC has downgraded from "BB (lka)" to "CC(lka)" after mainly considering factors such as weak capitalization, liquidity risk and severe deterioration in its assets quality. Further, this might have an influence on the repayment ability of the company.	Facility is in the Non-performing category at present and Bank is in the process of negotiating with the company for a reschedule.	Take necessary action to recover arrears from the customer.
v) Olympus Construction Limited A credit facility of Rs.350 million requested by Olympus Construction Limited for working capital requirement (bearing loan number 110730000003) and it was approved at the Special Board Meeting held on 07 June 2019. Accordingly the bank had granted Rs.100 million and Rs.150 million credit facilities to the said company on 08 July 2019 and 28 October 2019 respectively. Subsequently it had been transferred to non performing category on 07 January 2020 at the early stage of granting. As at 31 December 2021, total amount of Rs.298 million was remaining without recovering and days past due was 785. Further, the bank had vested the aforesaid property on 24 March 2021 and still the bank was not able to sell it.	Bank has obtained opinion of reputed legal consultant on 5th November 2021.And accordingly served letter of demand on 7th December 2021 against the two guarantors. Case was filed on 28th January 2022. The 1st calling date was given on 25/05/2022. The defendants filed proxy on this date. The 1st date for answer of the defendants was given on 1st September 2022. As per the legal opinion the "Bank can sell the excavated soil in order to cover the total amount due to the Bank on account of the loan, interest, expenses and costs". Accordingly management had discussed with one of the soil excavator and it was not success. Bank is in the process of finding suitable	Take necessary steps to recover this loan outstanding without delay.

	soil excavators, Reclamation contractors and any other potential parties those who are exclusively involved in Kadawatha- Meerigama stretch in the Central express way.	
vi) Madampe Mill (Pvt) The bank had granted Rs.50 million to a customer at a concessionary rate of 9 per cent for a period of 5 years with a grace period of 2 years on 13 September 2016. Further the loan repayment period had been extended up to 7 ½ years inclusive of a grace period. Total outstanding balance as at 31 December 2021 was Rs.65.48 million. The Company had failed to achieve their projected manufacturing targets as per their project proposal. After obtaining the loan the company had recorded a loss of Rs.109.4 million and Rs.12.9 million in the year 2020 and 2021 respectively. Total arrears as at 31 December 2021 was Rs.19, 053,308. Further following observations are made in this regard, • Contrary to the section 4.2.11 in the Credit Operations Manual, the bank had granted 78.13 per cent of forced value as a loan amount and In addition to the land mortgage, two directors of the company had been pledged as personal guarantees for the aforesaid credit facility.	Madampe Mill paid a nominal amount of Rs 1Mn each month from June onwards. They have already paid the last two months and agreed to deposit the same amount until December 2022 and intend to request a restructuring plan in tandem with their cash flow.	Proper income evaluation should be taken by the bank before granting the loan facility and take necessary action to recover arrears from the customer.

• Contrary to section 3.4.5 (a) of the Credit Operation Manual, the bank had obtained third party property as the security. Since mortgage property is owned by Managing Director's wife, who is not a director of the company.		
B. Loans and Advances – Employees' Provident Fund (EPF)		
i. Total outstanding value of loans which were granted against the Employee Provident Fund as at 31 December 2021 was Rs.14,000 million and out of that, a sum of Rs.9,302 million had been treated as non-performing and it represents 66 per cent of the total outstanding. Further, it was observed that loans amounting to Rs.324 million had been categorized under watch status which had a risk of subsequently become Non performing status.	All arrears EPF Loans were claimed once a year from CBSL in April or May and NPL position will come down in these months normally. Most of the EPF customers apply this loan with the intention of enjoying their EPF Balance for housing purpose but without the intention of repaying the Loan. But At the time of granting the loan proper evaluation is done by Credit Officers to check the repayment capacity of the customers and they inform the customers the importance of paying the loan on time to safe guard their EPF Balance at retirement. Now we are checking the CRIB and loans are not granted for customers who are having irregular CRIB Reports. Further we are planning to get transferred customer's salary if possible and feasible in business angle to our Bank which is not followed by the bank currently with the intention of reducing NPL.	Take necessary steps to recover these loans

ii.	It was observed that even a single Equaled Monthly Instalment (EMI) had not been paid for 2,528 number of EPF loans granted during the period 2016 to 2021 November amounting to Rs.1,187 million (9.43 per cent) out of total EPF loan (Capital with capital arrears) as at 31 December 2021.	11 credits related training programs were conducted for branches during 2022. During these programs credit evaluation has been emphasized. Branches have been advised to inform EPF loan customers about the importance of repayment at the time of obtaining EPF loans and also during payment.	Proper action need to be taken to recover EMI.
C.	**Advance on leasing facilities**		
	The total outstanding balance of advances on Leasing as at 31 December 2021 was Rs.1,002 million and non-performing balance of advances on Leasing as at that date was Rs.222 million which represents 22 per cent of total outstanding balance of advances on Leasing. Further it was observed that 119 leasing facilities valued to Rs.131 million were categorized under watch status which had a risk of subsequently become Non performing status.	Executive Officer from Leasing Division has been entrusted with monitoring the branch recoveries centrally to manage the lease portfolio NPL. As at 31 March 2022 NPL ratio was 13.17%. Total portfolio is Rs.923 million and NPL portfolio is Rs. 122million.	Take necessary steps to recover these outstanding balances.
D.	**Top 10 Depositors**		
	Total top 10 depositors are amounting to Rs.3,481 million and the 28 per cent of top 10 depositors represent Samurdhi Development Department and Samurdhi Micro Finance Banking Fund which is amounting to Rs.973 million. Further, when compared with previous year, top 10 depositors were amounting to Rs.6,344 million and it had been declined by 45 per cent to Rs.3,481 million in the year under review.	Higher deposit concentration results in liquidity risks in the event, major depositors recall their deposits. To mitigate liquidity risk, the following strategies have been implemented by the bank to reduce top ten deposit holder's percentage to manageable level. • Maximum single customer deposit holder percentage is limited to 10.00% of total savings deposits portfolio of the bank	Strategic decision making need to be taken to reduce the dependence on few larger deposit holders.

	• To introduce an advertising campaign to mobilize retail deposits and continue throughout the year. • To introduce new corporate customers to the bank. As per the result of implemented said strategies top twenty deposit holder percentage has been decreased to 6.59% as at 30 July 2022 from 28.00% as at 31 December 2021. Further, devinaguma department related deposits were fully settled by the Bank during last seven months period.	

3.5 Procurement Management

Audit Issue -----------------	Management Comment -------------------------------	Recommendation ----------------------
Noncompliance with the Government Procurement Guidelines of the National Procurement Agency circular No. 08 of 25 January 2006. Contrary to Paragraph 2.1.1 of Procurement Guideline and Public Finance circular PF/429(i), the bank had used their own procurement manual without obtaining approvals from Board of Directors and Director General of Public Finance.	According to Supplement 35 of National Procurement Guideline 2006, it is applicable to GOSL and foreign-funded projects only. As HDFC Bank projects are self-funded these guidelines do not apply to us. Currently, we use National Procurement Guideline only as a supporting document where necessary.	Take necessary actions to adhere with the cited direction.

4. Accountability and Good Governance

4.1 Corporate Governance of the Bank

Audit Issue	Management Comment	Recommendation
Succession Plan for Key Management Personnel i. As per the section 3(1)(i)(j) of the banking direction 12 of 2007 on Corporate Governance, Board approved succession plan for the Key Management Personnel should be in place. Even though, the existing succession plan should be amended in the year 2021, no any amendments were made in the year 2021.	Succession Plan was reviewed and approved by the Board in year 2022.	Adhere with the banking direction.
ii. As per the section 3(6) (ii) (i) (I) of the banking direction 12 of 2007 on Corporate Governance, Performance of the CEO and Key Management Personnel should be evaluated against the set targets at the beginning of every year. However, it was observed that there was a delay in submitting performance evaluations of KMPs to Board Human Resource and Remuneration Committee.	Now we have obtained the approval from Board Human Resource and Remuneration Committee and the Board of Directors for 2020 & 2021 performance evaluations of KMPs.	Adhere with the banking direction.