

## **Housing Development Finance Corporation Bank of Sri Lanka -2013**

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The audit of financial statements of the Housing Development Finance Corporation Bank of Sri Lanka for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 (1) of the Finance Act, No. 38 of 1971 and Section 26(2) of the Housing Development Finance Corporation Bank of Sri Lanka Act, No. 7 of 1997 as amended by Act, No.15 of 2003 and Act, No. 45 of 2011. My comments and observations which I consider should be published with the annual report of the Bank in terms of Section 14(2) (c) of the Finance Act appear in this report.

### **1.2 Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

### **1.3 Auditor's Responsibility**

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor

considers internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **2. Financial Statements**

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### **2.1 Opinion**

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In my opinion, the financial statements give a true and fair view of the financial position of the Housing Development Finance Corporation Bank of Sri Lanka as at 31 December 2013 and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

## **2.2 Comments on Financial Statements**

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### **2.2.1 Matter for Emphasis**

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More than 42 per cent deposits of the bank as at 31 December 2013 is owned by twenty depositors and as compared with that in the preceding year it was 47 per cent which indicates that the bank is dependent on few depositors and exposed to high liquidity risk. Further, it was observed that this situation would adversely affect the going concern of the Bank.

## 2.2.2 Unreconciled Differences

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The following differences had been identified between the balances shown in the General Ledger and the confirmation received from the Central Bank of Sri Lanka (CBSL) with regard to refinance loan balances as at 31 December 2013.

Description	Balance as per General Ledger	Balance as per CBSL Confirmation	Difference
	Rs.	Rs.	Rs.
United State Aid (USAID)	5,080,499	129,467	4,951,032
Asian Development Bank II (ADB II)	65,568,497	34,189,201	31,379,296

## 2.2.3 Unidentified Deposits

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Unidentified Deposits aggregating Rs. 3,054,126 had been recognized as income and accounted under sundry income for the year under review on the approval of the Board of Directors without making any disclosures in the financial statement.

## 2.2.4 Transactions of Contentious Nature

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The following observations are made.

### (a) Proposed Income Sources and Fees

The Board of Directors of the Bank at their meetings held on 26 September 2013 and 31 October 2013 had approved to charge the new income sources as loan administration fees on every outstanding loan with effect from 1 January 2012. Accordingly, Rs. 88,382,116 had been accounted for as revenue for the year under review. However, it was observed that the unrealized loan administration fees were Rs. 48,736,213 as at 31 December 2013.

Further it was observed that this action would contradict with the function stated in the Housing Development Finance Corporation Bank of Sri Lanka Act, No. 7 of 1997 as amended by Act, No.15 of 2003 and Act, No. 45 of 2011 which specify

that the Bank should formulate and implement schemes for the provision of housing for the economically disadvantage section of the society.

It was also observed that the Bank had claimed a sum of Rs. 46,541,725 as loan administration fee from the Employee Provident Fund with regard to “Srama Udana Loans” which are issued against balances in the Employee Provident Fund without written notice to the customers.

**(b) Staff Bonus**

Bank had not paid staff bonus for its employees for the year 2012. Instead, Bank had granted special staff loan facility of Rs. 22,201,113 for that purpose and accounted as an asset under “Special Staff Loan” to avoid the increasing of loss for the year 2012. However, Bank had granted an additional staff bonus amounting to Rs. 23,026,123 in the year 2013 for the purpose of settling the above mentioned “Special Staff Loan”. Therefore, the Bank had incurred an additional expense by the similar amount.

**(c) Purchase of T-Shirts**

A tender valued at Rs. 995,100 had been awarded to a private firm for the supply of 1860 T-Shirts in the year 2012. Later the supplier had refused to supply T-Shirts. The following observations are made in this regard.

- (i) The cheque worth of Rs. 497,550 drawn on 22 September 2012 for an advance payment had not been handed over to the supplier and kept in the administration division nearly six months and subsequently, cancelled on 21 March 2013.
- (ii) A performance bond had not been obtained from the supplier.
- (iii) During our physical inspection on 23 October 2013, it was observed that no such firm is in existence at the address mentioned in the Procurement documents and also it was not a registered supplier of the bank. However, the Procurement Committee was misled by forwarding supplier’s details as registered suppliers by the Technical Evaluation Committee.

**(d) Investment Property**

- (i) A land at No. 441, Sangaraja Mawatha with an extent of 59.20 perches had been revalued in year 2012 and 2013 with a surplus of Rs. 53,081,000 and Rs. 6,120,000 respectively. However, according to the valuation report of the panel of valuer of the bank dated 18 December 2013, there may be certain legal restriction to its realizing full open market value due to the sewerage and drainage lines are going through the land.
- (ii) Two lands at No.192, Srimath Bandaranayaka Mawatha with an extent of 138.20 perches purchased from Building Material Corporation had not been revalued and taken into account in the year 2012. The Bank had revalued this property at Rs. 504,430,000 with a surplus of Rs. 145,112,000 in the year 2013. However, the Bank had sued Building Material Corporation for the vacant possession of the said property in 2007. The order in the above case had been delivered on 18 October 2012 in favor of the Bank. At the meantime, the Building Material Corporation had made an appeal against this verdict.

**(e) Special Gratuity**

According to the LKAS 19 (Employee Benefits), the Bank should make sufficient provision for any future obligation. However, the Bank had granted a special gratuity payment to its employees since 2007 who had completed a service period of 15 years or more in addition to the regular gratuity payment without making any provision in the accounts with regard to this special gratuity payment and only the payment made each year had been accounted on each basis up to year under review. Further, it was observed that according to the Actuarial Valuation Report dated 31 December 2013 the actual liability of special gratuity payment was Rs. 92,820,161. However, the Bank had provided only Rs. 46,410,080 or 50 per cent as liability in the financial statements for the year under review.

**(f) Employee Share Option Plan (ESOP)**

The Bank had increased the share capital and other assets by Rs. 49,838,646 under the Employee Share Option Plan (ESOP) through a private firm without effecting a financial transaction.

**3. Financial Review**

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**3.1 Financial Results**

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According to the financial statements presented, the operations of the Bank for the year ended 31 December 2013, had resulted in a after tax profit Rs. 158.01 million as compared with the corresponding after tax profit of Rs. 55.53 million in the preceding year thus indicating an increase in the after tax profit by Rs. 102.48 million or 182 per cent. The recognition of revaluation gain of Rs. 95 million on investment property is mainly attributed for this increase in the financial results of the year under review.

**3.2 Analytical Financial Review**

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**3.2.1 Summary of the Financial Result**

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A summary of financial results for the year ended 31 December 2013 as compared with the preceding year is given below.

Item	2013	2012
	(Rs. Mn )	(Rs. Mn )
Interest Income	3,528	2,635
Interest Expenses	(2,469)	(1,805)
Net Interest Income	1,059	830
Non interest Income	275	109
Net Income	1,334	939
Staff Cost	(586)	(458)
Other Expenses	(352)	(304)
Impairment Charges for Loan & Other Losses	(87)	(1)
<b>Operating Profit before Taxes</b>	<b>309</b>	<b>176</b>
Value Added Tax	(78)	(50)
Tax Expenses	(73)	(70)
<b>Profit for the year</b>	<b>158</b>	<b>56</b>

While the interest income and interest expenses had increased by 33.89 per cent and 36.79 per cent respectively, the other expenses had increased by 34.34 per cent as compared with the preceding year. At the meantime non-interest income had increased by 152 per cent as compared with the preceding year. Net interest income on interest expense for the year under review was 43 per cent as compared with that in the preceding year of 46 per cent which shows a deterioration of 3 per cent.

### 3.2.2 Significant Accounting Ratios

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According to the information made available, some of the important accounting ratios of the Bank for the year under review and the preceding year are given below.

	<b>2013</b>	<b>2012</b>
	%	%
<b>Profitability Ratios</b>		
(i) Net Profit Ratio	4.15	2.02
(ii) Net Interest Income to Interest Income	30.01	31.48
(iii) Interest Cost to Interest Income	69.99	68.52
(iv) Overhead Expenditure to Net Interest Income	88.55	91.86
(v) Return on Average Assets	0.65	0.27
(vi) Return on Equity	6.36	2.35
(vii) Earnings per Share (Rs.)	2.44	0.86
<b>Capital Adequacy Ratio</b>		
(i) Equity to Total Assets	9.34	11.50
(ii) Equity to Borrowings	49.04	74.40
(iii) Tier i ( CBSL Norms 5 % )	17.74	23.75
(iv) Tier ii (CBSL Norms 10 % )	18.29	24.41
<b>Liquid Assets Ratio</b>		
Liquid Assets Ratio (Minimum 20 per cent)	28.74	22.65

### 3.3 Operating Review

#### 3.3.1 Cost of Funds and Yield

Description	Base on cumulative cost and revenue		
	Avg. Balance Rs. 000	Cost / Revenue Rs. 000	Rate (%)
<b>Deposits</b>			
Savings Deposits	2,084,635	99,892	4.79
Fixed Deposit	13,445,900	2,016,254	15.00
Dhananidana	402,418	44,228	10.99
Other Deposits	5,707	269	4.72
<b>Sub Total Deposits</b>	<b>16,631,592</b>	<b>2,160,643</b>	<b>12.99</b>
<b>Borrowings</b>			
<u>Commercial Borrowings</u>			
Bank Overdraft	67,901	1,119	1.65
Borrowing from Market	2,036,449	217,943	10.70
<b>Sub Total Commercial Borrowings</b>	<b>2,104,350</b>	<b>219,062</b>	<b>10.41</b>
<b>Other Borrowing</b>			
Special Scheme Loans	1,060,985	37,482	3.53
Refinanced Loans	991,864	52,081	5.25
<b>Sub Total Other Borrowing</b>	<b>2,052,849</b>	<b>89,563</b>	<b>4.36</b>
Cost of Funds on Mobilization	<b>18,735,943</b>	<b>2,379,705</b>	<b>12.70</b>
Other Liabilities	2,888,175	-	-
Capital	962,093	-	-
Reserves	1,519,289	-	-
	<b>24,116,500</b>	<b>3,414,722</b>	<b>14.16</b>
Less:			
Other Assets	1,391,714		
Financial Cost	22,724,785	2,469,268	10.87
Overhead Costs	22,724,785	1,035,017	4.55
<b>Total Cost of Funds</b>	<b>22,724,785</b>	<b>3,504,285</b>	<b>15.42</b>
Loan Portfolio	17,833,503	2,922,126	16.39
Investment	4,905,406	606,091	12.36
<b>Financial Yield - Performance</b>	<b>22,738,910</b>	<b>3,528,217</b>	<b>15.52</b>
Margin	22,738,910	23,932	0.11
Feebased Other Income	22,738,910	285,360	1.25
<b>Margin</b>	<b>22,738,910</b>	<b>309,292</b>	<b>1.36</b>
Tax	22,738,910	151,284	0.67
<b>Net Margin</b>	<b>22,738,910</b>	<b>158,008</b>	<b>0.69</b>



According to the cost of funds and yield report of HDFC Bank, Financial Yield (Loan & Investment) was 15.52 per cent for the year under review, whereas the Bank had obtained fixed deposit amounting to Rs. 1,700 million from CEB Provident Fund at an interest rate of 18 per cent which is over and above the average financial yield of 2013.

### 3.3.2 Maturity Profile of the Bank

Analysis of the profile of the assets and liabilities of the Bank on a monthly level revealed that the total liabilities were far in excess and the short term liquidity gap up to 3 months and 3-12 months in the year under review were negative of Rs. 4,703 million and negative of Rs. 3,174 million respectively. Details are given below.

	As at 31 December 2013					
	Up to 3 Months Rs.000	3 to12 Months Rs.000	1 to 3 Years Rs.000	3 to 5 Years Rs.000	More than 5 Years Rs.000	Total Rs.000
<b>Assets</b>						
Cash	101,867					101,867
Due from Banks	166,223					166,223
Investments	4,304,569	1,941,389	87,313		31	6,333,302
Loans and Advances	1,112,307	1,545,735	4,749,714	4,138,321	8,155,262	19,701,339
Fixed Assets					289,537	289,537
Other Assets	29,222	23,919	76,580	20,036	825,457	975,213
<b>Total Assets</b>	<b>5,714,188</b>	<b>3,511,043</b>	<b>4,913,607</b>	<b>4,158,356</b>	<b>9,270,287</b>	<b>27,567,481</b>
<b>Liabilities</b>						
Total Capital Fund					2,575,222	2,575,222
Deposits	9,161,038	6,297,743	1,383,766	1,369,640	701,460	18,913,646
Borrowings	613,171	385,244	1,232,143	1,763,202	1,257,928	5,251,689
Other Liabilities	642,969	1,597	7,526	165,654	9,178	826,924
<b>Total Liabilities</b>	<b>10,417,178</b>	<b>6,684,584</b>	<b>2,623,435</b>	<b>3,298,496</b>	<b>4,543,788</b>	<b>27,567,481</b>
<b>Maturity Gap</b>	<b>(4,702,990)</b>	<b>(3,173,541)</b>	<b>2,290,172</b>	<b>859,860</b>	<b>4,726,499</b>	<b>Nil</b>

#### **4. Systems and Controls**

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Weaknesses observed in the systems and controls during the course of audit were brought to the notice of the Chairperson of the Bank by my detailed report issued in terms of Section 13 (7) (a) of the Finance Act. Special attention is needed in respect of the following areas of control.

- (a) Investment Property
- (b) Cost of Fund
- (c) Proposed Income Sources and Fees
- (d) Loan Administration
- (e) Procurement Guidelines
- (f) Human Resources Management