

### 1.1. Adverse Opinion

The audit of the financial statements of the Lankaputhra Development Bank Limited (“Bank”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows 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. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, because of the significance of the matters described in paragraph 1.5 of this report, the financial statements do not give a true and fair view of the financial position of the Bank as at 31 December 2018, 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 Adverse Opinion

I have expressed an adverse opinion based on the matters described in paragraph 1.5 of this report.

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

### 1.5.1. Non – Compliance with Sri Lanka Accounting Standards

<b>Non compliance with the reference to particular Standard</b>	<b>Management Comment</b>	<b>Recommendation</b>
Sri Lanka Financial Reporting Standard – SLFRS 9 Financial Instruments shall be applicable for financial reporting periods beginning on or after 01 January 2018. However, financial statements of Lankaputhra Development Bank had not been prepared in accordance with SLFRS 9 and therefore, impact on the above standard to the financial statements couldn't be assessed.	Issue has already been corrected after acquisition by Pradeshiya Sanwardhana Bank.	Take necessary actions to prepare financial statements in accordance with applicable standards.

### 1.5.2. Accounting Policies

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
As per note no.3.7.1. of the financial statements, the service of a qualified actuary is obtained once in every 3 years to determine the valuation of defined benefit obligation. However, actuarial valuation had not been done since 2015.	Agreed and it will be corrected in 2019 with the acquisition by Pradeshiya Sanwardhna Bank.	Take necessary actions to prepare financial statements by applying accounting policies consistently.

### 1.5.3. Accounting Deficiencies

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
(i) A loan balance of USD 16,407,693 and interest payable of USD 20,509.66 have been converted to LKR using CBSL buying rate of Rs.180.72 instead of using CBSL selling rate of Rs.184.6966 as at	Corrected the related issue with the audit adjustment made on 29 July 2019.	Take necessary actions to convert assets and liabilities denominated in foreign currencies using appropriate rates.

31 December 2018. Therefore, the loan payable balance and interest expense have been understated by Rs.65,328,390 as at 31 December 2018.

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| <p>(ii) Unidentified deposits made by customers amounting to Rs.1,484,470 had not been accounted even though these balances appeared in the bank statements as at 31 December 2018.</p>                                                                                                                                                                           | <p>Already branches have been informed to reconcile bank accounts and clear unidentified deposits.</p>                                                                                                                                                                                                                                                      | <p>Take necessary actions to prepare financial statements correctly.</p>                                        |
| <p>(iii) A difference of Rs.6,895,607 had been observed between the balance as per physical verification and balances as per general ledger in respect of consumables, stationeries and promotional items of head office as at 31 December 2018.</p>                                                                                                              | <p>Attention has been given to reconcile the related difference.</p>                                                                                                                                                                                                                                                                                        | <p>Take necessary actions to reconcile any difference with the general ledger balance and physical balance.</p> |
| <p>(iv) Lease interest income on vehicle had been recognized in the financial statements on cash basis.</p>                                                                                                                                                                                                                                                       | <p>Transactions have been recorded manually due to unavailability of proper Computer System and this will be corrected for future leasing transactions.</p>                                                                                                                                                                                                 | <p>Take necessary actions to recognize lease interest income on accrual basis.</p>                              |
| <p>(v) As per the note no.18 to the financial statements, accumulated depreciation of computer software was Rs.30,377,146 which merely equals to the cost at the beginning of the year. However, in the note no.19.2 of the financial statements fully depreciated computer software was Rs.1,066,448 only and these notes are contradictory with each other.</p> | <p>Note no.19.2 to the financial statements, states fully depreciated assets of computer hardware as Rs. 78,103,241 and this includes fully depreciated computer software of Rs. 23,741,136. However, we have stated fully depreciated computer software as Rs. 1,066,448. Therefore, total cost of fully depreciated software should be Rs.24,807,584.</p> | <p>Take necessary actions to prepare financial statements correctly.</p>                                        |

#### 1.5.4. Unreconciled Control Accounts or Records

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
(i) A balance of Rs.20,108,614 in clearing control account had not been cleared as at 31 December 2018.	Related balance have been cleared after 31 December 2018 and the balance reported as at 30 September 2019 was Rs.1,873,526.	Take necessary actions to clear these control accounts without any delay and prepare financial statements correctly.
(ii) A credit balance of Rs.4,932,495 had been remained in the unidentified customer deposit account as at 31 December 2018 without being identified.	Related balance has been cleared up to Rs. 4,522,653 as at 31 July 2019.	Take necessary actions to clear these unidentified customer deposits without any delay and prepare financial statements correctly.

#### 1.5.5. Suspense Accounts

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
Without operating two separate accounts for suspense accounts creditors and suspense accounts debtors, the bank had maintained only one suspense account. A credit balance of Rs.13,598,183 had been remained in above suspense account and it had been categorized under other assets in the financial statements as at 31 December 2018. Due to the aforesaid credit balance understatement of assets and understatement of liabilities by Rs.13,598,183 was observed.	The issue had been arisen due to amalgamation with SME bank and it is proposed to present for Assets and Liability Committee meeting of Pradeshiya Sanwardhna Bank.	Take necessary actions to prepare financial statements correctly.

#### 1.5.6. Inappropriate Valuation or Estimation

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
(i) Rs.69,692,025 had been shown as income tax expense in the income statement for the year 2018. Computation of the above amount was not made available to the audit.	The related position will be rectified with the final tax payment for the year 2018.	Take necessary actions to prepare tax computations in accordance with applicable regulations.

(ii) Overstatement of VAT on financial services expense and understatement of profit for the year by Rs.4,772,824 was observed. Further, VAT payable balance as at 31 December 2018 had been overstated by Rs.4,346,948.	The related issue had been corrected with the audit adjustment made on 29 July 2019.	Take necessary actions to prepare tax computations in accordance with applicable regulations.
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**1.5.7. Going Concern of the Bank**

**Audit Issue**

As per the note no.2.7.ii of the financial statements, board has made an assessment of the bank's ability to continue as a going concern, and the financial statements had been prepared on the above basis. However, Pradeshiya Sanwardhana Bank acquired the 100 per cent equity stake in Lankaputhra Development Bank in line with government budget proposal of year 2016 thereby proposed Lankaputhra Development Bank to be merged with Pradeshiya Sanwardhana Bank and this matter had not disclosed in the financial statements.

**Management Comment**

It was a government decision and formally informed the bank after submitting financial statements on 7 February 2019.

**Recommendation**

Transferring of ownership of Lankaputhra Development Bank had been taken place with effective from 31 December 2018 and therefore, necessary actions should be taken to prepare financial statements with appropriate disclosures.

**1.5.8. Documentary Evidences not made available to Audit**

**Audit Issue**

A balance of Rs.1,432,019 had been remained in SME Debtors Account as at 31 December 2018 without recovering it from year 2012. Further any proof document was not made available to the audit.

**Management Comment**

The related issue had been arisen due to amalgamation with SME bank and it is proposed to present for Assets and Liability Committee meeting of Pradeshiya Sanwardhana Bank.

**Recommendation**

Take necessary actions to recover the balances if any without any delay.

## 2. Financial Review

### 2.1. Financial Result

The operating result of the year under review amounted to a profit of Rs.227.8 million and the corresponding profit in the preceding year amounted to Rs. 298.2 million. Therefore deterioration amounting to Rs. 70.4 million of the financial result was observed. The reasons for the deterioration are decrease in interest income, increase in impairment loss on financial assets and increase in other related expenses.

### 2.2. Trend Analysis of major Income and Expenditure items

Interest income had been decreased by Rs. 85.8 million or 10 per cent as compared with previous year. The major reason for the above deterioration was decrease of interest income from loans and advances by Rs.93.7 million or 32.9 per cent as compared with previous year. Interest expense had been decreased by Rs. 12.3 million or 16.6 per cent compared to the year 2017. Decrease of customer deposits by Rs.77.7 million or 19.3 per cent compared to year 2017 was affected to the above deterioration. Other operating income had been increased by Rs. 130.6 million or 730 per cent as compared with previous year due to gain on foreign currency revaluation.

### 2.3. Ratio Analysis

Following observations are made with regard to some important accounting ratios of the Bank for the year under review as compared with sector ratios.

- (i) A high net interest margin of 7.68 per cent and net profit ratio of 25.36 per cent had been reported in the year under review as compared with the average Licensed Specialized Bank (LSB) ratios of 3.25 per cent and 3.82 per cent respectively.
- (ii) Return on Equity of 4.23 per cent had been reported for the year under review as compared with the average Licensed Specialized Bank ratio of 7.12 per cent.
- (iii) High Non-performing loan (NPL) ratio of 46.5 per cent had been observed as at 31 December 2018 which is far above the LSB average ratio of 4.8 per cent.
- (iv) Total Capital Adequacy Ratio of the Bank is 95.76 per cent as at 31 December 2018 which is excessively high level than the minimum requirement of 11.875 per cent.
- (v) The Liquid Assets Ratio of the Bank was further increased to 1,864.37 per cent as at 31 December 2018 as compared with the minimum requirement of 20 per cent.

## 3. Operational Review

### 3.1. Identified Losses

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
As per the physical verification carried out by the internal audit division of Pradeshiya Sanwardhana Bank at the Nawala premises as at 31 March 2019,		Take necessary actions to reconcile general ledger balances with physical balance and to recover the loss from related parties.
(a) It was observed that	Detail verifications are	
inventory at a cost of	conducting to reconcile the	

Rs.6,304,959 and Net difference with the physical Book Value of Rs.788,043 stock. was not available.

- (b) Three laptops, one ipad and two iphones purchased during the years of 2015 and 2017 at a cost of Rs.779,689, had not been returned by the former chairman and working director. Equipment had not been returned by the former Chairman and Working Director and matter is to be attended in the formal manner.

### 3.2. Management Inefficiencies

Audit Issue	Management Comment	Recommendation
During the year, total of Rs.109, 395,497 had been paid to the Treasury as capital and interest installments for GOSL USD loan using CBSL buying exchange rate. However, above loan installments need to be converted using CBSL selling rate and therefore, loan installments paid during the year 2018 had been understated by Rs. 2,470,413.	This will be considered when making future payments and the Lankaputhra Development Bank's policy is to use CBSL average Dollar rate for Dollar assets & liabilities.	Take necessary actions to settle GOSL USD loan using appropriate rate.

### 3.3. Under -utilization of Funds

Audit Issue	Management Comment	Recommendation
(i) Bank had invested large proportion of money in fixed deposits at a risk free interest rate without granting loans to customers. This is contradicted with the primary objective of the Bank of assist in the promotion, establishment, expansion, modernization and development of the industrial, agricultural, commercial, construction	Bank has granted loans to reach its primary objective and investments have been made in fixed deposits to control Non Performing Loans of the Bank.	Take necessary actions to achieve the primary objective of the Bank.

and other enterprises.

(ii) At the meeting held on 9 October 2013 in the Department of Development of Finance with General Managers of Pradeshiya Sanwardhana Bank and Lankaputhra Development Bank, Rs.200 million had been given by the Government to Lankaputhra Development bank as a guarantee fund.

Take necessary actions to implement the decisions as agreed in the meetings and settle any liabilities remained to the treasury.

(a) As per the condition no.02 of the meeting minute, Rs.200 million should be invested in Pradeshiya Sanwardhana Bank at the rate of 7 per cent per annum. However, Rs.100 million only had been invested in Pradeshiya Sanwardhana Bank and balance of Rs. 100 million invested in other commercial banks by Lankaputhra Development Bank.

There is no written agreement to implement the guarantee fund scheme. However as agreed at the meeting, Rs.100 million has been deposited with the Pradeshiya Sanwardhana Bank.

(b) Further, 50 per cent of annual interest income should be added to the fund yearly. However, annual interest income had not been transferred to the fund after 2016.

Corrected after acquisition by Pradeshiya Sanwardhna Bank.

(c) All disbursed loans under this scheme had been recovered by Pradeshiya Sanwardhana Bank in 2018. However, any evidence was not available to the audit regarding the repayment of above fund or continuance as revolving fund.

Agreed.

(iii) Rs. 50 million had been given by Mahaweli Authority to Lankaputhra Development Bank on 12 November 2009 to continue stage III of Mahaweli Loan Scheme. As per the section 2 'a' and 'b' of the agreement, Lankaputhra Development Bank should pay the loan in four annual installments within 5 years including one year grace period with 4 per cent annual interest. However, the Bank had not followed that terms and remained as a payable balance in the financial statements for more than 9 years.

Bank has accounted the total liability as Rs.68,196,761 as at 31 December 2018 and Mahaweli Authority has confirmed the above balance. Further, this fund has been invested by the bank for higher rates.

Take necessary actions to close the schemes which are not in operation after settling payable balances.