

**1. Financial Statements**

**1.1 Opinion**

The audit of the financial statements of the Housing Development Finance Corporation Bank (the“Bank”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the statement of profit or loss and other 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 and Finance Act No.38 of 1971. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2022, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**1.2 Basis for Opinion**

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

## 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 through out 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 over ride 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 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 Audit Observations on the preparation of Financial Statements

### 1.5.1 Internal Control over the preparation of financial statements.

Audit Issue	Management Comment	Recommendation
(i) A difference of Rs.47 million was observed between the balance of loan portfolio and the general ledger.	This was due to system error and Rs.46,175,259.95 has been already rectified while Rs.797,668.05 in the process of rectifying with the core banking vender. Non-reconciled amount reduced to Rs.797,668.05. The necessary process is being carried out to rectify this issue.	Take necessary action to identify the difference and rectify immediately.
(ii) Loan recoverable balance of Rs.503, 282 in relation to 10 numbers of vested properties remained in the vested property account (2500904001) and it had not been inserted in the Loan Management System (LMS).	Prior to the year 2000, the accounting policy was to settle vested property accounts and record the balances of those credit accounts in the separate G/L ledger. After the year 2000, the above accounting policy changed and a vested property account identification code (code No -06) was applied. Accordingly, the balances of the vested property account before the year 2000 are only in the ledger account. However we will update the ledger accounts with the details of such properties	Action need to be taken to rectify the issues identified.

## 1.6 Accounts Receivable and Payable

### 1.6.1 Payables

Audit Issue	Management Comment	Recommendation
(i) The excess amount of Rs.932,619 received from Vested Property selling was remaining in the Over Recovery Account (1310190028) without paying to the respective customers. However, the balance of Rs.902,213 represents over one year balance as at 31 December 2022.	Actions are being taken to refund these balances in 2023.	Necessary actions need to be taken to repay the excess balances to respective customers.

(ii) An amount of Rs.1.04 million was remaining in the Creditors Stock Purchase Account (1310190072) for more than 5 years period. Further, Rs.4.2 million remaining in the Supplier Payable Account (1310210012) had not been cleared for more than one year period.

Item wise investigation is going on and settlement will be completed in 2023.

Actions need to be taken to clear the long outstanding balances with immediate effect.

(iii)

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

Reference to Laws, Rules Regulations	Non-compliance	Management Comment	Recommendation
(i) Direction and Guideline issued by CBSL a) Banking Act Direction No.13 of 2021 dated 14 September 2021 - Section 9.1.6	<b>Models of Calculations of Impairment</b> The Chief Executive Officer (CEO) and relevant Key Management Personnel (KMPs) of the Licensed Bank under the guidance provided by Board of Directors, shall ensure that establishes an effective model validation process to ensure that the credit risk assessment and measurement methods are capable of generating accurate, consistent and unbiased predictive estimates on an ongoing basis. However, any evidence in relation to the model validation process of the Bank had not been presented for the audit during the year under review.	Currently model valuation is not done by IAD due to a lack of expertise knowledge. These findings will be escalated to the Board Audit Committee and the Board and directions on adequately resourcing the IAD will be obtained. Additionally, we have requested from HR division to arrange a training program for the same.	Adhere to cited Banking Act Direction issued by Central Bank of Sri Lanka (CBSL).
- Section 14.2	<b>Role of Internal Audit</b> The internal audit function shall at least annually, validate and evaluate all credit risk assessment models, inputs and assumptions used along with data smoothening, if any. However, any documentary evidences had not been submitted by the internal Audit Division in order to ensure that they have complied with these requirements.	Currently model valuation is not done by IAD due to a lack of expertise knowledge. This findings will be escalated to the Board Audit Committee and the Board and directions on adequately resourcing the IAD will be obtained. Additionally, we have requested from HR division to arrange a	Adhere to cited Banking Act Direction issued by CBSL.
- Section 14.3	The internal audit function shall provide		

an assurance on the adequacy and effectiveness of back testing in order to ensure that the key drivers have been captured and calibrated accurately. However, it was unable to obtain any evidence to ensure that required functions have been carried out by the Internal Audit to provide an assurance on the adequacy and effectiveness of back testing.

training program for the same. After gathering the required knowledge we will validate and evaluate models in future.

b) Section 06 (a) of Financial Transaction Reporting Act No. 06 of 2006 and Extraordinary Gazette dated 25 June 2008

Every institution within the meaning of the aforesaid Act shall report to the Financial Intelligence Unit, every cash transaction or electronic funds transfer of an amount exceeding Rupees one Million or its equivalent in any currency. However, according to the information made available to the audit, the Bank had not reported over 1 million transactions since February 2023.

Agree to the concern. The reason for the delay is lack of compatibility of existing data in our system with "goAML" due to some mismatches and deficiencies of data fillings. It has to be corrected manually contacting branches and the process is time taking. Without completing/correcting all the errors, it cannot be submitted through the "goAML".

Adhere to the cited Act.

Steps have been taken to issue instructions for branches to minimize errors and to avoid the delay in submission of EFT/CTRs. further emphasized the requirement of timely submission complying with regulatory provisions.

c) Section 2.9 of Banking Act Directions No. 4 of 2014 dated 26 June 2014 on amended to the Banking Act Directions No.7 of 2011 dated 05 October 2011 on IRM frame work for the Licensed

All Banks should be implemented the baseline security standard for information security management. However, it was observed that 5 controls in acquisition, development and maintenance of information systems had not been complied with by the bank. Further, out of 95 controls of 14 security domains, bank was able to comply with only 45 controls during the year 2022.

Agree with the comments. The Bank is in the continuous process of achieving the BSS requirements. The staff is deployed to achieve set standards while managing the existing resources. The improved status of compliance is stated below. The bank has a

Need to follow cited Direction.

Banks, with effect  
from 01 July 2015

plan to meet all  
compliances before 31<sup>st</sup>  
March 2024.

**(ii) Pawning Direction  
issued by CBSL**

a) Section 15 (7)

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 about the amount for which the article was sold and the amount lying to the credit of the pawned after deducting the cost of postage and the charges. However, excess money amounted to Rs.1, 520,409 received from pawning auction had been remained in auction gold loan account (1310170013) since more than one year period.

The excess amounts in the accounts have been notified to the customers. However, customers have not responded. Therefore, further actions are being taken to pay out this excess amount in 2023.

Need to follow cited Direction.

**(iii) Loan Recovery  
Manual/Credit  
Recovery Manual**

a) Section 4.1.9

**Advances received on Auction Properties**

When the tenders were not approved by the tender board, the tender amount should be returned to the relevant depositors within a reasonable time. However, it was observed that the excess money of Rs.3.24 million was remaining in the Advanced Received on Auction Properties ledger account for more than one year without paying to the respective depositors.

Actions are being taken to refund these balance in 2023.

Action need to be taken to repay the excess money to the respective bidders.

**(iv) Office Instructions  
for the Gold Loan**

a) Section 18.3

Action to be initiated to conduct an auction when the advances granted under the Gold Loan became non-performing after three months from the expiry date of the contracted period. However, 04 numbers of Gold Loans amounting to Rs.384,000 were remained under NPL category as at 31 August 2021 (at the time of physical verification). Details are given below.

Gold Loan Ticket		Advance Paid for Article	Observation
Number	Date	(Rs.)	
112800000157	08/05/2017	200,000	Identified as a dud article and still insurance claim had not been received by the bank.
112800000510	17/06/2020	73,000	Identified as a doubtful article and branch had sent it to gold loan section at Head office for further investigation.
112800000554	07/10/2020	86,000	
112800000517	08/07/2020	25,000	Action had not been taken according to the instructions.

- 112850000157 – Actions Awaiting for insurance claim need to be taken to sell the articles through auctions and recover the non-performing advances.
- 112850000510, 112800000554-We have already put up a complaint to Piliyandala police station to get a court order for further investigations of suspicious article to check through gem and jewelry authority. The articles related to mentioned loans were handed over to the head office.
- 112850000517 – Visited the customer's address but was unable to contact the customer. To be forwarded for next pawning auction.

**(v) Operation Manual**

a) Section 2 (2.2) of the Manual on Operations, Internal Circular No. GCL/2012/094 (Revision 1) dated 24 October 2016, GCL/2012/094 (Revision 02) dated 24 August 2022 and ALCO paper No.05 dated 28 May 2018

When opening a life and smart goal savings account such as Prathilaba, Thilina, Niwasa Ayojana, Vishrama Rekawarana, the minimum balance should be deposited to such accounts. However, the bank had opened 19 savings accounts with “0” balances during the year 2022. Details are given below.

Type of Savings Account	Number of Accounts
Prathilaba	09
Thilina	01
NiwasaAyojana	03
VishramaRekawarana	01
Set For Life	01
Smart Goals	04
<b>Total</b>	<b>19</b>

Branches were informed us these accounts has been opened erroneously. Instruction has been given to the branches to cancel accounts through operation division. Necessary actions are in progress to rectify the issues.

Need to comply with cited Directions. .

**(vi) Internal Circulars**

a) Circular No. GCL/2012/084 (Revision 07) dated 05 August 2021

It is compulsory to transfer client’s full salary or loan installment by the employer to the Bank and disbursements should be done only after transferring the salary or EMI to the respective Bank account. However, Piliyandala branch had disbursed 04 loans to Hydramani Group and 07 loans to other institutions without getting the salary or EMI transferred.

Noted, Advised the credit officers to follow the circulars in future. Disbursements are released by Loan Administration division after remitting the standing order or salary.

Need to comply with cited Circular Instructions.

**1.8 Non -compliance with Tax Regulations**

Audit Issue	Management Comment	Recommendation
(i) According to Section 200 (Chapter XVIII) of the Inland Revenue Act, No. 10 of 2006, an entity shall claim the excess paid tax, if it is proved to the satisfaction of Commissioner - General by any claim duly made in writing within three years from the end of the year of assessment. It was observed that the bank had identified an over paid stamp duty of Rs.13,311,541 for the period from 2006 to 2015 and informed to the Inland Revenue	These are excess payment of stamp duty on loan receipts which are exempted by IRD ACT. As per the tax consultation opinion which will be recovered from	Necessary actions need to be taken to recover the overpaid amount of Stamp Duty.



Department in the year of assessment 2015. Though the Bank need to recover the overpaid stamp duty with in three years from the end of the year of assessment 2015, the Bank has not acted accordingly.

future payables.

## 1.9 IT General Controls

Audit Issue	Management Comment	Recommendation
(i) Backups of the Bank are not stored at a proper off-site location. The Bank stores the backup media at Hide Park Corner Branch with inappropriate physical security measures such as surveillance cameras, access controls and alarms. Due to important data backed up in an inappropriate off-site location, the data may expose to theft, fire and other local disasters. This practice may compromise data integrity and confidentiality and could result in possible misuse of financially significant data. Further, the leading practice would be to maintain backups in a location which is minimum of 30 km away from the primary data center and an appropriate and safe place with relevant security and controls as well.	Agreed with the comments and will shift the off-site backup location.	Necessary measures need to establish to safeguard the important data backups.
(ii) User access review is a control to be periodically verified to ensure that only legitimate users have accessed to the applications. However, it was observed that the Bank has not performed a periodic review in year 2022 towards the appropriateness of the user access to the system.	We will introduce a new methodology to review user access periodically. User access review process will start from July 2023 onwards.	A periodic user access review need to be performed on annual base.
(iii) It was unable to verify, whether the branch CCTV Camera systems are operating in accordance with the section 25 (administrations and maintenance of the CCTV cameras) of CBSL Guideline No. 02/2021 dated 20 July 2021, since most of the occasions there were no proper record keepings maintained by branches.	Record keeping system will be introduced on or before 15.09.2022	Proper record keeping of CCTV Cameras need to be maintained by the Bank.
(iv) As per the Circular No. 01/2022 dated 10 January 2022 of CBSL financial intelligent unit, the Financial institutes (FI) should maintain all information captured in the CCTV system for minimum of 90 days' period. However, as per the comments of the bank, it was in the range of 10 to 40 days.	CBSL has now reduced their requirement to 90 days. We will comply with their requirement in future installation.	Need to comply with the CBSL Circulars and directions.

- (v) As per the CBSL Guideline No. 02/2021 dated 20 July 2021, every Financial Institution was advised to install a robust CCTV system which is fully operational both within and outside of the premises. The business premises refer to the Head Office, Branches, and areas of Automated Teller Machines, Cash Recycling Machines and Cash Deposit Machines (ATM/CRM/CDM), Cash Centers, Outlets and any other place or places where Customer Due Diligence is conducted. However, it was observed that there was no any CCTV installed in Kiribathgoda branch within the Automated Teller Machine premises.
- Requested Memo send to Technical division on 28.11.2022  
Need to comply with the CBSL Guideline.

## 2. Financial Review

### 2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.326 million and the corresponding profit in the preceding year amounted to Rs.547 million. Therefore, a deterioration amounting to Rs.221 million of the financial result was observed. The main reasons for the deterioration are the increase in Interest Expense by Rs.2,123 million, increased in Personal Cost by Rs.157 million and Other Expenses by Rs.132 million.

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

Items	2022 (Rs. Mn)	2021 (Rs. Mn)	Percentage of Change over Previous year
Interest Income	8,425	6,612	27.42
Interest Expenses	(5,679)	(3,556)	59.70
<b>Net Interest Income</b>	<b>2,746</b>	<b>3,057</b>	<b>(10.17)</b>
Net Fee and Commission Income	353	343	2.92
Other Operating Income (Net)	100	49	104
<b>Total Operating Income</b>	<b>3,198</b>	<b>3,448</b>	<b>(7.25)</b>
Impairment Charges for Loans & Other Losses	(320)	(296)	8.11
<b>Net Operating Income</b>	<b>2,878</b>	<b>3,152</b>	<b>(8.69)</b>
Staff Cost	1,544	1,387	11.32
Other Expenses	722	566	27.56
<b>Operating Profit Before Value Added Tax</b>	<b>612</b>	<b>1,199</b>	<b>(48.96)</b>

VAT on Financial Services	309	320	(3.43)
Tax Expenses	(24)	331	(107.25)
<b>Profit for the year</b>	<b>326</b>	<b>547</b>	<b>(40.40)</b>

### 2.3 Ratio Analysis

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	2022	2021
<b><u>Profitability Ratios</u></b>		
(i) Net Profit Ratio (Percentage)	3.68	7.81
(ii) Net Interest Income/ Interest Income (Percentage)	32.59	46.22
(iii) Interest cost to Interest Income (Percentage)	67.41	53.78
(iv) Return on Average Assets (Percentage)	0.52	0.88
(v) Return On average Share Holders Fund (Percentage)	4.99	9.02
<b><u>Capital Adequacy Ratios</u></b>		
Tier I (Minimum 8.5%)	26.56	22.38
Tier II (Minimum 12.5%)	27.61	23.02
<b><u>Liquid Assets Ratios</u></b>		
Liquid Assets Ratio	31.52	26.6
<b><u>Other Ratios(In Rupees)</u></b>		
Earnings Per Share	5.04	8.46
Net Assets Per Share	103.79	98.18
Market Value Per Share as at end of the Year	27.8	30.5

- a) Net Profit Ratio had decreased from 7.81 percent (2021) to 3.68 percent (2022) and Net Interest Income had also decreased from 46.22 (2021) to 32.59 (2022) during the year under review. The reasons for the related changes are the increase in interest expense and the increase in personal and other expenses.
- b) Return on Average Assets and Return on Average Share Holders Fund had decreased from 0.88 percent (2021) to 0.52 percent (2022) and 9.02 percent (2021) to 4.99 percent (2022) respectively during the year under review. The main reason for the identified drop in these ratios is the decrease in net profit.

- c) Earnings per Share had decreased from 8.46 (2021) to 5.04 (2022) and Market Value per Share as at end of the year had been decreased from 30.5 (2021) to 27.8 (2022) in the year under review.

### 2.3.2 The Market Share of the Bank based on the loans and advances and total deposits are shown below.

#### (a) Market Share based on Loans and Advances.

	2022 -----	2021 -----	2020 -----	2019 -----	2018 -----
Total Loans and Advances of the Bank (Rs. million)	44,637	43,572	42,659	42,360	38,812
Total Loans and Advances of the Market (Rs. million)	995,902	925,168	801,650	760,057	712,511
Market share of the Bank (as a percentage)	4	5	5	6	5

#### (b) Market Share based on Deposits

	2022 -----	2021 -----	2020 -----	2019 -----	2018 -----
Total Deposits of the Bank (Rs. million)	50,245	49,813	47,947	42,504	37,016
Total Deposits of the Market (Rs. million)	1,856,219	1,762,633	1,553,621	1,277,529	1,084,612
Market share of the Bank (percentage)	3	3	3	3	3

### 2.3.3 Borrowings of the Bank

	2022 Rs Million	2021 Rs Million	2020 Rs. Million	2019 Rs. Million	2018 Rs. Million
Total Borrowings	4,135	5,090	5,542	6,866	6,653
Shareholders' Funds	6,716	6,354	5,782	5,119	4,757
Debt to Equity Ratio	0.62	0.80	0.96	1.34	1.40
Leverage Ratio (Gearing Ratio)	38%	44%	49%	57%	58%
Interest Cover Ratio	1.5	3.0	2.6	2.1	1.8

Debt to Equity Ratio of the year under review was 0.62 which indicates low gearing situation of the Bank. It's debt to equity ratio had been reduced throughout the last five years period by making a favorable situation for the Bank. This was due to settling its debt capital by the Bank during the last five years period. However, interest Cover Ratio has decreased by 50 per cent when compare with the previous year.

### 3. Operational Review

#### 3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
<p>(i) <b>Sale of Vested Properties</b> The Bank had sold 09 Vested Properties during the year 2022 which had a recoverable balance of Rs.10.13 million and incurred a loss of Rs.1.81 million at the time of selling.</p>	<p>We have already taken necessary action to transfer the excess amount of Rs.405.92 to the borrowers savings account for loan 106500000850 and Rs.30,000.00 to the Interest Income Account for loan 107500000290.</p>	<p>Necessary actions need to be taken to avoid or minimize the losses to the Bank from underlined transactions.</p>
<p>(ii) <b>Fraudulent Loans granted in Ampara Branch</b> Seven fraudulent loans amounting to Rs.8 million had been granted to Sumithra Hasalaka (Pvt) Ltd by the Ampara Branch in the year 2018 and subsequently those loans had been transferred to non performing category. The aggregated outstanding balance of these loans as at 31 December 2022 was Rs.12.6 million.</p>	<p>We are already taken necessary actions to recover these loans.</p>	<p>It is recommended to strengthen the internal control system of the Bank to avoid fraudulent activities and follow recovery action to recover outstanding balance.</p>
<p>(iii) An aggregated capital balance with interest which was in arrears amounting to Rs.5.53 million had been waived off by the Bank during the year 2022 in relation to 151 non-performing loans and advances.</p>	<p>The bank had to write off loans due to unforeseen credit risks at the time of evaluation and weak recovery actions. This situation was aggravated due to the adverse macroeconomic factors that prevailed in the country. Even though the loans were written off based on a prudent basis, the recovery process is continuing. The management implemented many processes and procedures to eliminate such weaknesses.</p>	<p>Proper customer evaluation needs to be performed by the Bank at the time of loan granting and proper recovery actions need to be taken.</p>
<p>(iv) Central bank had refused to pay 70 EPF customers' with aggregated arrears of Rs.3.45 million for the period of 2022, due to non-availability of EPF funds/records due to deleted from the loan system. It may cause a loss of Rs.12.49 million to the Bank.</p>	<p>Your observation is duly noted and having understood the gravity the CIA is assigned to investigate 70 EPF cases. Currently investigations are going on to recover these loans. Once the investigation is over will submit the management response. Appropriate</p>	<p>Necessary actions need to be taken to avoid or minimize the losses to the Bank from underlined transactions.</p>

disciplinary actions will be initiated if there is negligence or misconduct.

### 3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
<p>(i) <b>Loan granted for Very Important Professionals</b> 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 for the period from 2016 to 2018. Out of that, 29 loans amounting to Rs.73.5 million or 25.97 per cent had been categorized as non-performing as at 31 December 2022. However, there is no any secondary recovery option to the Bank due to unavailability of security for these loans.</p>	<p>Recovery actions taken court case filed for 06 loans and management decided to initiate action against promissory notes for other loans.</p>	<p>Proper customer evaluation needs to be performed by the Bank at the time of loan granting and proper recovery actions need to be taken.</p>
<p>(ii) As per the Board Paper No. 07/258/2022 dated 18 January 2022, Bank has decided to vacate the Trincomalee lease premises from 31 March 2022 before the expiry of the lease agreement. The Bank had also entered into a new agreement for a period covered from 1 April 2022 to 31 March 2027. However, new premises were not ready to use until the end of December 2022 due to delay in refurbishment works. As a result, the Bank had to pay Rs.887, 250 for the existing lease premises and Rs.495,000 for the new lease premises as well. It was observed that the Bank had incurred an additional expense due to weak planning of relocating the Trincomalee branch.</p>	<p>We were not in a position to relocate the Trincomalee branch due to the following reasons.</p> <ul style="list-style-type: none"> <li>• Delay in Central Bank approval.</li> <li>• Country's economic situation at that time. Ex: Fuel crisis, lack of raw materials, restrictions of imports etc.</li> </ul>	<p>Timely and correct decisions need to be taken to avoid or minimize the losses to the Bank.</p>
<p>(iii) Even though the evidences were there in relation to the inability of repayments by the customer, the Bank has made forecasts for below mentioned credit facilities without considering those evidences.</p>	<p>Agreed. 107850000042 Judgment to be delivered on the case filed in respect of this lease. Cash flow planned based on the status of the legal case. However, going forward more accurate cash flows will be obtained based on objective evidences available to branches. 303730000001 The property had</p>	<p>Cash flow forecasting should be acceptable and accurate.</p>

Loan Number	Cash Forecasted in the year 2021 Amount (Rs.)	Amount Received during the year 2022 (Rs.)	Cash Forecasted in the year 2022 Amount (Rs.)	Amount Received in the year 2023 (First 3 months) (Rs.)	Observation
101730000016	13,621,174	2,334,933	5,070,951	400,014	Customer had requested for a grace period of 06 months on 12 April 2022 and without considering that, the Bank had forecasted that the customer will pay his EMI amounting to Rs.1.69 million continuously till his loan maturity.
101521000106	7,835,004	Nil	1,958,751	Nil	Customer had requested for a grace period of 06 months on 12 April 2022 and without considering that, the Bank had forecasted that the customer will pay his EMI amounting to Rs.652,917 continuously till his loan maturity.
101730000007	28,706,409	2,750,428	4,077,420	Nil	Customer had agreed to pay Rs.1million up to December 2022 according to the letter dated 18 July 2022 and without considering that the Bank had forecasted customer will pay his EMI amounting to Rs1.36 million continuously till his loan maturity.

been planned for auction in January 2023 and cash flows had been planned accordingly.

However, customer had obtained an injunction against the sale.

114730000024

This loan is in normal status. Repayment starts from December 2023. The interest accrued had been given as cash flow incorrectly.

(iv) Some credit facilities which were considered for the Loss Given Default (LGD) computation has not been categorized under nonperforming category during the credit history of such facilities. Due to this, LGD, which was used for computation of collective impairment, had been understated.

When deciding Accurate and contracts which complete should classified information should under stage 3 (non-performing loans) be used for the PD and LGD

Analysis is as follows.

Category	Computation as per Bank		Performing loans		Percentage of Performing Loans considered for LGD Computation
	1st NPL Balance	Sum of Loss	1st NPL Balance	Sum of Loss	
Guarantor	37,885,512.57	152,270.38	30,973,189.00	116,920.00	81.75%
EPF	112,036,229.72	668,503.37	50,060,954.00	16,862.00	44.68%
Mortgage	58,355,124.53	46,109.68	29,763,890.86	7,933.00	51.00%

bank consider computations. contracts which have more than 90 days past due and rescheduled contracts during the period. Further bank has manually adjusted the system DPD for moratorium granted facilities. Accordingly, both these conditions have been considered for the stage calculation and such contracts have been considered for LGD calculation.

### 3.3 Operational Inefficiencies

	Audit Issue	Management Comment	Recommendation
(i)	<b>Loans and Advances –Performing &amp; Non Performing Loans excluding EPF and Leasing)</b>		
a.	The total outstanding balance of loans and advances as at 31 December 2022 was Rs.26,532 million and non-performing loans and advances as at that date was Rs.5,357 million or 20 per cent of total outstanding balance of loans and advances. Further, Rs.2,178 million or 8.2 per cent were categorized under watch status which had a risk of subsequently categorized into non performing category.	Agree with the concerns stated and management is taking appropriate actions to reduce NPA of the Bank.	Actions need to be taken to maintain the non-performing loan ratio of the Bank at a lower level and in parallel with the sector ratio
b.	The total capital outstanding balance of 149 Corporate Loans as at 31 December 2022 was Rs.1, 506 million. Out of that Rs.852 million (36 loans) had been categorized into the non-performing category as at 31 December 2022. Further, it was observed that Rs.59 million which were categorized under watch status has a risk of subsequently categorized into none performing category.	Agree with the concerns stated and management is taking appropriate actions to reduce NPA of the Bank.	Need to give more attention and follow up steps should be taken to recover the Corporate Loans outstanding balance.



- c. Loans which were disbursed and transferred to Non- performing category during the year 2022

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 Out of 15,937 numbers of loans granted during the year 2022, 15 per cent or 2,747 numbers of loans were transferred to Non- performing category and total capital outstanding balance of such loans as at 31 December 2022 was Rs. 1,351 Million. Out of the total loans granted during the year 2021, 10 per cent of loans were transferred to the Non- Performing category thus showing an increase of 5 per cent in the year under review when compare with the preceding year.

The economic crisis in the country resulting in high inflation has resulted in the payment of EMI difficult. However, the unexpected increase in interest rates along with income reduction resulted in repayment difficult. It is observed that in the banking sector, the NPL ratio increase from 8.4% (1st qtr2022) to 12.7% (1st qtr 2023).

Proper Customer evaluations should be done before granting loans.

(ii) **Loans and Advances – Employees’ Provident Fund (EPF)**

- (a) Total outstanding value of loans which were granted against the Employee Provident Fund as at 31 December 2022 was Rs.13,777 million and out of that, a sum of Rs.9,100 million had been categorized as non- performing and it represents 66.05 per cent of the total outstanding balance of loans and advances. Further, it was observed that Rs.341 million was categorized under watch status which had a risk of subsequently becoming under Non performing category.
- (b) Even a single EMI had not been received for 2,814 numbers of EPF loans granted during the period from 2016 to 2022 November. The aggregated value of these loans was Rs.1, 470 million (Capital with capital arrears) and it represents 10.67 per cent from total EPF loans of the Bank as at 31 December 2022. 6,155 numbers of EPF loans valued at Rs.3, 502 million had been granted during the year 2022 and out of that, no any EMI payment had been received for 2,443 numbers of EPF loans valued at Rs.1, 269 million during the year 2022.

There is a practice among borrowers of EPF loans to default payment on the loan allowing annual claim from the fund to take place. Some borrowers obtain the loan with that intention which cannot be evaluated at the credit evaluation stage. Further controls like salary remittance have not worked since the competitor institutions are offering relaxed conditions. However, we have strengthened the recovery effort on EPF loans.

Take necessary steps to recover these loans.

The recovery process has been changed and more emphasis put for collection of EPF dues since March 2023.

Proper action need to be taken to recover these loans. .

(iii) **Advance on Leasing Facilities**

The total outstanding balance of Advances on Leasing as at 31 December 2022 was Rs.758 million and non-performing balance of this category as at that date was Rs.150 million or 19.78 percent of total outstanding balance of advances on Leasing. Further it

Previously recovery function for leasing facilities was done from leasing division where during certain periods a responsible officer was not

Take necessary steps to recover these outstanding balances.

was observed that 92 leasing facilities valued at Rs.119 million were categorized under watch status which had a risk of subsequently becoming categorized under Non performing category.

there to do the recoveries. However, management discussed the issue and has transferred the recovery of leasing also to the Recovery Department with the objective of strengthening this function. Since then there is a clear recovery improvement.

**(iv) Vested Properties**

Capital with interest outstanding balance of loans categorized under Vested Properties as at 31 December 2022 was Rs.390.17 million. Age analyzes of outstanding balances are as follows.

Years	Capital with Interest Outstanding as at 31.12.2022		No of properties	Percentage
	Capital	Interest		%
Less than 1 year	1,700,827.07	2,338,387.75	2	0.54
Over 1-2 years	249,717,321.19	51,893,845.05	1	79.12
Over 2-3 years	7,493,797.90	1,642,945.85	1	2.37
Over 3-4 years	31,791,053.49	6,846,274.72	9	10.07
Over 4-5 years	11,214,297.28	2,188,402.64	2	3.55
Over 5 years	13,709,537.47	9,636,765.11	87	4.34
Grand Total	315,626,834.40	74,546,621.12	102	100

We have sold 09 vested properties during the year 2022 with the Board approval. We agree with delay of disposing vested properties. The Management is taking appropriate actions to dispose vested properties.

Steps should be taken to recover the outstanding balance on a timely manner.

**(v) Top 10 Depositors**

The aggregated amount of top 10 fixed depositors was Rs.2,223 million as at 31 December 2022. The Samurdhi Prajamoola Bank Society and Samadhi Community Based Bank Society are representing the fixed deposits value of Rs.1183 million which represents 53 per cent of the total top 10 depositors' value.

The Bank strategically reduces dependence on the top 10 depositors to mitigate the concentration risk and manage the liquidity risk by moving from corporate depositors to retail depositors.

Strategic decisions need to be taken to reduce the dependence on few larger deposit holders.

#### 4. Procurement

Audit Issue	Management Comment	Recommendation
<p>The bank had awarded the project of Debt Recovery Management System to Avonet Technologies (PVT) Ltd. On 2018 for Rs.12 million and entered into an agreement on 21 May 2019 for a cost of Rs.9.9 million.</p>	<p>The Management has discussed with the vendors and as a result reduced the cost. We agree with your concern of weak documentation and process implemented to document future activities.</p>	<p>Need to maintain proper documents for the procurement activities.</p>
<p>(a) Even though, as per the negotiations, the price reductions should be obtained from the bidder in writing by the Bank. However, the bank was unable to submit such document to the audit.</p>		
<p>(b) Performance Bond had been expired on 05 March 2020 and a request has been made on 26 February 2020 by the secretary to the tender board for extend the said bond. However, extended Performance Bond had not been submitted to audit.</p>	<p>Agreed with the concern and respective officers have negotiated with the supplier and agreed to submit a fresh performance security on or before the end of May 2023. In order to avoid such lapses, we will initiate disciplinary actions for respective officers.</p>	<p>Necessary actions need to be taken to extend the agreements and bonds if expired and provide such documents to the audit.</p>