

Housing Development Finance Corporation Bank of Sri Lanka - 2012

1. Financial Statements

1.1 Opinion

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 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Matter for Emphasis

Out of the total customer deposits of the Bank, more than 47.29 per cent is owned by twenty depositors as at 31 December 2012, as compared with 47.08 per cent in the preceding year which indicates that the bank is more dependent on very limited depositors and exposed to high liquidity risk. Hence, it was observed that this situation would adversely affect the going concern of the Bank.

1.2.2 Sri Lanka Accounting Standards (SLFRS and LKAS)

Following observations are made.

- (a) The Bank had not made an Actuarial Valuation to determine the fair value of the gratuity provision as at 31 December 2012, in terms of LKAS 19 (Employee Benefits).
- (b) Despite to the LKAS 19 (Employee Benefits), the Bank had not maintained planned assets in order to discharge the obligation under a defined benefit plan. (a fund or qualifying Insurance policy).

1.2.3 Accounting Deficiencies

Even though the Board of Directors had decided to auction a property mortgaged for a Loan categorized under loss which had been granted to a housing project, the Bank had identified and accounted future cash inflows of this property under fair value model for the year under review. Details are as follows.

Loan No.	Granted Amount	Date of the Board Paper
	Rs.	
P020000001	10,000,000	08/06/2012

1.2.4 Unreconciled Differences

Following differences had been identified between balances shown in the General Ledger and the confirmations sent by third parties with regard to refinance Loan balances as at 31 December 2012.

Description	Balance as per	Balance as per third	Difference
	General Ledger	party Confirmation	
	Rs.	Rs.	Rs.
United State Aid (USAID)	26,986,311	22,517,903	4,468,408
Asian Development Bank II (ADB II)	85,676,993	44,965,266	40,711,727
Affordable Housing Finance Scheme (AHF)	739,848,788	739,809,088	39,700

1.2.5 Unidentified Deposits

The amount of unidentified Deposits as at 31 December 2012 as per the General Ledger was Rs. 3,181,292 out of which 99.5 per cent was over two years. Details are given below.

Age (Years)	Numbers	Amount Rs.	Percentage
01-02	4	15,965	0.50
02-05	115	335,920	10.56
05-10	1023	2,104,838	66.16
Over 10 years	319	724,568	22.78
Total	1461	3,181,291	100

1.2.6 Non compliance with Laws, Rules and Regulations

Bank shall recognize interest on an account which has been classified as non-performing loan income, as and when the interest is collected by the bank, if it is collected on a cash basis. However, the Bank had accounted Penalty Interest Income on defaulted EPF Loans on accrual basis, instead of cash basis in terms of Banking Act, Direction No.4 of 2008 5 (1).

1.2.7 Transactions of Contentious Nature

Following observations are made.

(a) Staff Bonus

The Bank had not paid staff bonus for the employees of the Bank for the year under review. Instead, Bank had granted Special Staff Loan Facility as per the circular No.SCL/2012/16 dated 4 December 2012 and spent a sum 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 under review which would be estimated at Rs. 19,748,946. It was also noted that the management had decided to grant these interest free loans with 06 months grace period. Further, it was observed that the Bank had not effectively utilized funds in a low profitable situation.

(b) Investment Property

Following observations are made.

- (i) According to paragraph No. 33 of LKAS 40 “Investment Property”, if an entity that choose the fair value model to measure its property, all of its investment property should be measured at fair value. Accordingly, the Bank had valued a land for Rs. 207,000,000 and recognized a revaluation surplus of Rs. 53,081,000. However, another three investment properties had not been valued at fair value.
- (ii) The value of the Awissawella Housing Project classified as Investment Property was shown as Rs. 179,310,709 in the financial statements as at 31 December 2012. However, according to valuation report as at 31 December 2011, value of this land was only Rs. 175,211,200. Therefore the accuracy of the values shown in the financial statements is in doubt.
- (iii) Value Added Tax amounting to Rs. 498,429 had been paid by the Bank instead of being collected from the buyer with regard to three houses in the Awissawella Housing Project which had been sold at Rs. 5,630,000.

(c) Special Gratuity

According to the collective agreement, Bank had granted a Special Gratuity Payment to the employees who have completed a service period of 15 years or more beside to Normal Gratuity from the year 2007. It was observed that the Bank had not provided any provision in the accounts with regard to this Special Gratuity from 2007, and payments had been made on cash basis up to the year under review. According to the Board decision dated 09 June 2011, management had recognized the necessity of making a provision for the Special Gratuity but refrained from doing so due to material effect to the profitability of the Bank.

- (d) A loan amounting to Rs. 1.8 million granted by the Bank through fraudulent documents had been written off during the year under review which was categorized under Non Performing Loan. It was observed that a Banking Assistant of the HDFC Bank had closed the loan account by depositing one rupee (Rs. 1.00) of her own money. As per the Chairman of the Bank, an investigation was in progress on this issue.
- (e) The Bank had increased the share capital and other assets by Rs. 49,842,936 under the Employee Share Option Plan (ESOP) through a private firm without effecting a financial transaction. It was accounted under the name of a private firm as other assets.
- (f) Contrary to the normal interest rates, the Bank had agreed to pay 22.1 per cent to Ceylon Electricity Board for a fixed deposit of Rs. 450 million, where the over payment of interest would be Rs. 69,391,353 by the date of maturity. The Bank had stated that there had been a documentation error made by the officials, and without knowing the correct situation the Board of Directors also had granted the approval.

1.2.8 Stock Verification

Following observations are made.

- (i) The difference identified between the General Ledger balance of the stock and the physically verified balance as at 31 December 2012 amounting to Rs. 7,576,128 had been charged against revenue as printing and stationery expenses without being identified.
- (ii) Unidentified stock as per the stock reconciliation statement valued at Rs. 1,533,284 had also been credited to the printing and stationery expenses account without being identified.

- (iii) An unsettled advance of Rs.1,065,150 made for gift items as at 31 December 2012 which also caused to the stock difference had been credited to the printing and stationery expenses accounts without being credited to relevant creditors accounts, resulting an overstatement of profit by the same amount.

1.2.9 Loans and Advances

Following observations are made.

(a) Non Performing Loans (NPL) Position

Bank had recorded the NPL ratio at 20.20 per cent as at 31 December 2012 while in average NPL ratio in the banking sector was less than 06 per cent.

(b) Loans against Employees Provident Fund (EPF)

92 claims of defaulted EPF loans amounting to Rs.4.2 million had been rejected by the Central Bank of Sri Lanka due to various reasons and informed to the Bank on 20 March 2012. However, the Bank had not taken necessary action to resubmit those claims until 31 January 2013 and also no provision had been made for these outstanding loans for the year under review.

2. Financial and Operating Review

2.1 Financial Results

According to the financial statements presented, the operations of the Bank for the year ended 31 December 2012, had resulted in a net profit of Rs. 2.5 million after tax as compared with the corresponding net profit of Rs. 216 million after tax in the preceding year thus indicating a decrease in the net profit by Rs. 213.5 Million, or 99 per cent. According to the revised budget for the year 2012, the estimated net profit was Rs. 147 Million, and as compared with the corresponding actual net profit for the year under review indicating a decrease in the net profit by 98 per cent.

2.2 Summary of Operating Results

A summary of operational financial results for the year ended 31 December 2012 as compared with preceding year is given below.

Item	2012 Rs.'000	2011 Rs.'000
Interest Income	2,634,758	2,260,966
Interest Expenses	(1,805,320)	(1,354,294)
Net Interest Income	829,438	906,672
Non Interest Income	58,458	83,664
Other Operating Income (net)	(1,820)	40,972
Total Operating Income	886,076	1,031,308
Staff Cost	(458,115)	(360,797)
Other Expenses	(303,799)	(258,787)
Impairment Charges for Loan and Other Losses	(1,496)	(10,063)
Operating Profit before Value Added Tax	122,666	401,661
Value Added Tax	(49,893)	(81,005)
Tax Expenses	(70,321)	(104,637)
Profit for the Year	2,452	216,019

While the interest income and interest expenses had increased by 17 per cent and 33 per cent respectively, the non interest expenses had increased by 21.24 per cent as compared with the preceding year. The personal cost had increased by 27 per cent as compared with the preceding year.

2.3 Cost of Funds and yield for the year ended 31 December 2012

Description	Based on cumulative cost and revenue		
	Average Balance Rs.'000	Cost / Revenue Rs.'000	Rate (%)
Deposits			
Savings Deposits	1,585,683	89,705	5.66
Fixed Deposit	7,794,636	1,107,473	14.21
Dhananidana	2,145,715	363,917	16.96
Other Deposits	20,425	37	0.18
Sub Total of Deposits	11,546,458	1,561,131	13.52
Borrowings			
Commercial Borrowings			
Bank Overdraft	51,352	2,624	5.11
Borrowing from Market	816,448	137,233	16.81
Sub Total of Commercial Borrowings	867,801	139,856	16.12

Other Borrowings			
Special Scheme Loans	1,053,931	39,483	3.75
Refinanced Loans	1,318,696	64,812	4.91
Other Borrowings	1,499	61	4.08
Sub Total of Other Borrowings	2,374,126	104,356	4.40
Total Cost of Funds	14,788,385	1,805,344	12.21
Other Liabilities	1,280,025	-	-
Capital	962,093	-	-
Reserves	1,454,249	-	-
	18,484,753	-	-
Less:			
Other Assets	1,052,808	-	-
Financial Cost	17,431,945	1,805,344	10.36
Overhead Cost	17,431,945	768,298	4.41
Total Cost of Funds	17,431,945	2,573,642	14.76
Loan Portfolio	14,846,850	2,278,680	15.35
Investments	2,585,095	356,737	13.80
Financial Yield - Performance	17,431,945	2,635,417	15.12
Margin	17,431,945	61,775	0.35
Freebased Other Income	17,431,945	58,083	0.33
Margin	17,431,945	119,858	0.69
Tax	17,431,945	85,787	0.49
Net Margin	17,431,945	34,070	0.20

2.4 Significant Ratios

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

Indicator	2012	2011
	%	%
Profitability		
(i)Net Profit Ratio	0.07	9.05
(ii)Net Interest Income/ Interest Income	31.48	40.10
(iii)Interest Cost to Interest Income	68.52	59.90
(iv)Overhead Expenditure to Net Interest Income	91.92	68.36
(v) Return on Average Assets	0.01	1.22
(vi) Return on Equity	0.10	10.32
(vii) Earnings per Share (Rs.)	0.04	3.34

Capital Adequacy Ratio

(i) Equity : Total Assets	11.50	11.73
(ii) Equity : Borrowings	74.98	65.71
(iii) Tier i	20.79	21.34
(iv) Tier ii	21.46	21.95

Liquid Assets Ratio

Liquid Assets Ratio (Minimum 20 per cent)	22.65	21.15
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2.5 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 Rs. 5,095 million and Rs. 4,142 million respectively. Details are given below.

As at 31 December 2012

	0-3 Months	3 -12	1 -3	3- 5	Over 5	Total
	Rs. (Mn)	Rs. (Mn)	Rs. (Mn)	Rs. (Mn)	Rs. (Mn)	Rs. (Mn)
		Months	Years	Years	Years	
<u>Assets</u>						
Cash	107.86	-	-	-	-	107.86
Due from Banks	93.52	-	-	-	-	93.52
Investments	1,878.71	1,406.34	79.25	79.25	34.02	3,477.57
Loans and Advances	853.97	1,121.45	3,464.18	3,024.57	7,501.50	15,965.67
Fixed Assets	-	-	-	-	288.12	288.12
Other Assets	24.78	60.67	9.60	6.62	766.20	867.87
Total Assets	2,958.84	2,588.46	3,553.03	3,110.44	8,589.84	20,800.61
<u>Liabilities</u>						
Total Capital Fund	-	-	-	-	2,391.21	2,391.21
Deposits	6,296.29	5,887.24	209.73	88.78	440.87	12,922.91
Borrowings	202.57	373.36	891.24	745.80	976.33	3,189.30
Other Liabilities	1,555.61	470.31	59.77	22.85	188.65	2,297.19
Total Liabilities	8,054.47	6,730.91	1,160.74	857.43	3,997.06	20,800.61
Maturity Gap	(5,095.63)	(4,142.45)	2,392.29	2,253.01	4,592.78	Nil

2.6 Delays in Projects

The Bank had expected to purchase a suitable Software package to replace existing outdated HR and Payroll package as per their Action Plan for the year 2012. The Tender Committee had recommended to purchase a software package from a Private Company and paid 50% advance of Rs. 1,380,000 on 14 June 2012. According to the agreement entered into with this Company, there should be 17 activities to be accomplished during the year under review. However, according to the letter dated 27 February 2013 of the IT Manager, the Bank had implemented only the reporting of staff attendance and maintaining of personal file of the staff members.

2.7 Performance of the Bank

(a) Deposits

According to the Revised Budget of 2012, the Bank had expected to increase their deposit base to Rs.14,262 million at the end of the year under review. However, the actual total deposits at that date was only Rs.12,923 million.

(b) Loan Portfolio

In terms of Corporate Plan for 2011-2013, the Bank had expected to grant a sum of Rs. 21,000 million value of loans by the end of the year 2012 and anticipated to grant Rs. 17,364 million value of loans as per Revised Budget 2012. However, the Bank had granted only Rs. 15,966 million of total loans by the end of the year under review.

(c) Financial Investment

Financial Investment of the Bank as at 31 December 2012 was Rs.2,288 million as compared with the corresponding amount of Rs.3,347 million in the preceding year thus indicating a decrease of Rs. 1,059 million or 31.64 per cent.

(d) Branch Performance

As usual, the Bank had not prepared financial statements in branch wise, even though there were 32 branches located in island wide. Therefore it was not possible to examine the branch performance properly.

3. Systems and Controls

Weaknesses observed in the systems and controls during the course of audit were brought to the notice of the General Manager of the Bank by my detailed report issued in terms of Section 13(7)(a) of the Finance Act No.38 of 1971. Special attention is needed in respect of the following areas of control.

- (a) Inventories and Stores Management
- (b) Loan Administration
- (c) Sale of Acquired Properties.
- (d) Maintaining of leave records
- (e) Investment Fund
- (f) Fixed deposits
- (g) Software Packages