

Housing Development Finance Corporation Bank of Sri Lanka - 2010

1. Financial Statements

1.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, I am of opinion that the Housing Development Finance Corporation Bank of Sri Lanka had maintained proper accounting records for the year ended 31 December 2010, and the financial statements have been prepared in accordance with Sri Lanka Accounting Standards and give a true and fair view of the state of affairs of the Bank as at 31 December 2010 and the financial results of its operations and cash flows for the year then ended.

In my opinion, the consolidated financial statements, give a true and fair view of the state of affairs as at 31 December 2010 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Bank, and its subsidiary dealt with thereby, so far as concerns the shareholders of the Bank.

Matters for Emphasis

Without qualifying my opinion I draw attention to the following matter.

The financial statements of the subsidiary of the Bank showed a declining trend in operational, financial and liquidity areas and these factors raise substantial doubt as to whether the subsidiary will be able to continue as a going concern in the foreseeable future.

1.2 Comments on Financial Statements

1.2.1 Sri Lanka Accounting Standards(SLAS)

The following observations are made

- (a) In terms of recognition principle mentioned in paragraphs 7 and 13 of the Sri Lanka Accounting Standards (SLAS) -18, the replacement cost for the property should be capitalized. But the Value Added Tax applicable on refurbishment cost of ground floor of the Head Office Building amounting to Rs.355, 054 had not been capitalized.

- (b) It is necessary to determine the cost of retirement benefits by obtaining actuarial valuations at frequent intervals(at least every three years is appropriate) in terms of paragraph 26 of SLAS 16. But the Bank had failed to obtain actuarial valuations.

1.2.2 Accounting Deficiencies

The total outstanding loan balance payable to Sri Lanka Insurance Corporation as at 31 December 2010 amounted to Rs. 196,235,777 and the amount payable within one year (December Installment) amounted Rs. 5,068,523. But the Bank had not shown the amount payable within one year under current liabilities.

1.2.3 Unreconciled Difference

According to the General Ledger, the unidentified customer deposits as at 31 December 2010 amounted Rs. 5,938,847, whereas according to the schedule that amount was Rs. 6,212,640 and the difference amounted to Rs. 273,793. Further, more than 99 per cent of the unidentified customer deposits were older than one year.

1.2.4 Accounts Receivable and Payable.

The following observations are made

- (a) According to the agreement entered into between a customer and the Bank, the customer had agreed to make an initial deposit of Rs. 5 million for the purpose of granting loans to the employees of Lanka Electricity Company (private) Limited and the company would replenish the deposit as and when required that is when loans exceeds the deposit. Even though the loans granted up to 01 February 2011, the date of audit had exceeded the deposit of Rs. 5 million by Rs. 3,217,468 the Bank had not taken action to obtain settlement for the excess money from the customer.
- (b) According to the Board approval granted on 29 August 2008, interest rate payable on the fixed deposit of the Ceylon Electricity Board amounting Rs. 450 Million with an interest rate of 22.2 per cent per annum if interest is paid on maturity or 18.55 per cent if paid annually. Contrary to that, the actual annual interest rate agreed by the Bank had been 22.1 per cent. As a result the total overpayment of interest would be amounted to Rs.69,391,353 by the date of maturity.
- (c) The Bank had granted loans against the Employees Provident Fund balances since the year 2001 and up to end of year 2010. However, the total non-performing loan balances receivable from 6,217 accounts aggregated Rs. 241,829,145. If there is any non-performing loan, it should be claimed from the Central Bank of Sri Lanka. But the Bank had failed to claim such non performing loan balances annually though the outstanding amounts ranging over a period from 12 to 97 months. Further it was observed that two loans had been granted to one member of the Employees Provident Fund, and the Bank had not recovered any installments from the second loan until the full settlement of the first loan.
- (d) Over recoveries of loans and advances aggregating to Rs.260,354, had been shown as a liability during the year under review without being refunded to the respective parties.
- (e) The total outstanding loan due on nineteen vested properties amounted to Rs.10,527,842, and the proceeds from the auctioning of such properties amounted to only Rs. 9,839,904. As a result the Bank had sustained a loss of Rs. 687,938.

Further the total outstanding balance of 169 non performing loans as at 31 December 2010 amounted to Rs. 24,525,887 and according to the valuation reports the market value of those properties amounted to only Rs.16,763,400.

1.2.5 Lack of Evidence for Audit

The difference between physical balance and general ledger balance of fixed assets as at 31 December 2008 amounted to Rs. 17,023,483 and the difference had been transferred to the Fixed Assets Disposal Accounts. But the details of assets were not made available for audit even by the end of February 2011.

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

The following observations are made

- (a) According to Section 16(2) of Housing Development Finance Corporation Act, No. 7 of 1997, issued share capital of the Bank should be Rs.1,000 Million. Nevertheless, even after the issue of employees' shares during the year under review the share capital stood at Rs 962.088 million only.
- (b) Six (06) unpresented cheques amounting to Rs.241,363 which the validity period lapsed for over 6 months had remained in the Bank Reconciliation Statements without being taken action in terms of the Financial Regulation 396(d).
- (c) According to Sections 5.1 and 5.2 of Chapter V of Public Enterprises Guidelines for Good Governance CircularNo.PED/12 dated 2 June 2003, updated copies of the Corporate Plan approved by the Board should be forwarded to the Auditor General at least 15 days before the commencement of financial year. However this requirement had not been complied with by the Bank.
- (d) According to Paragraphs 12(a) to (m) of Section II of the Housing Development Finance Corporation of Sri Lanka Act, No. 7 of 1997, the main objective of the Bank is to grant loans and other financial assistance for housing purposes and other related services. Contrary to that the Bank had deposited a sum of Rs.317 Million with the Central Bank of Sri Lanka to facilitate agricultural purposes.

2. Financial and Operating Review

2.1 Financial Review

2.1.1 Financial Results

According to the Financial Statements presented, the operations of the Bank for the year ended 31 December 2010, had resulted in a pre-tax net profit Rs. 188.9 million as compared with the corresponding pre-tax net profit of Rs. 91 million in the preceding year thus indicating an increase in the pre-tax net profit by Rs. 97.9 Million.

2.1.2 Operating Review

A summary of operational financial results for the year ended 31 December 2010 as compared with preceding three years is given below.

Item	2010 (Rs.' 000)	Increase/ (Decrease)	2009 (Rs.' 000)	Increase/ (Decrease)	2008 (Rs.' 000)	Increase/ (Decrease)	2007 (Rs.' 000)
Interest Income	2,164,981	(51,391)	2,216,372	275,070	1,941,302	245,701	1,695,601
Interest Expenses	1,339,355	242,752	1,582,107	19,956	1,602,063	(355,453)	1,246,609
Net Interest Income	825,626	191,361	634,265	295,024	339,240	(109,752)	448,992
Other Operating Income	85,305	32,979	52,326	19,241	33,085	(12,656)	45,741
Net Income	910,931	224,340	686,591	314,265	372,325	(122,409)	494,734
Operating Expenses	615,128	98,559	516,569	104,266	412,303	7,682	404,621
Provision for Bad Debts (Loan Loss)	106,895	52,942	53,953	24,551	54,402	11,426	42,976
Operating Profit/(Loss)	188,908	97,840	91,068	185,448	(94,380)	(141,517)	47,137

The interest income had decreased by 2.32 per cent while the interest expenses had decreased by 15.34 per cent and the operating expenses had increased by 19.08 per cent as compared with the preceding year. However, the expenses of personal emoluments and welfare had increased by 13.5 per cent only. It was observed that the office and other expenses had increased significantly in the year under review.

2.1.3 Financial Review

According to the information made available, a summary of financial position as at end of the year under review and the preceding year is given below.

Assets	2010	2009	Variance	
	(Rs.'000)	(Rs.'000)	(Rs.'000)	%
Cash and short term funds	84,272	163,189	(78,917)	-48.36
Investments in Government Securities and others	1,512,768	1,246,622	266,146	21.35
Loans and Advances	12,839,825	11,912,783	927,042	7.78
Interest Receivable	54,434	73,626	(19,192)	-26.07
Taxation Recoverable	3,721	24,899	(21,178)	-85.06
Investments Securities	31	-	31	
Other Assets	123,115	159,662	(36,547)	-22.89
Property, Plant and Equipment	755,667	720,660	35,007	4.86
Total Assets	15,373,832	14,301,441	1,072,391	7.50
Liabilities				
Deposits from Customers	7,702,928	6,114,802	1,588,126	25.97
Borrowings	4,781,007	5,150,224	(369,217)	-7.17
Other Liabilities	1,041,239	1,315,219	(273,980)	-20.83
Total Liabilities	13,525,174	12,580,245	944,929	7.51
Funds Employed				
Share Capital	962,089	962,089	0	0.00
Reserves	886,570	759,107	127,463	16.79
Total Capital and Reserves	1,848,659	1,721,196	127,462	7.41
Total Liabilities and Funds Employed	15,373,833	14,301,441	1,072,391	7.50

2.1.4 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 were as follows.

	2010	2009
	%	%
Profitability		
(i) Net Profit Ratio	12.94	7.42
(ii) Gross Profit Ratio	36.69	27.96
(iii) Interest Cost to Interest Income	61.86	71.38
(iv) Overhead Expenditure to Gross Profit	79.26	86.74
(v) Return on Average Assets	0.91	0.40
(vi) Return on Equity	7.58	3.30
(vii) Earnings per Share	20.91	8.72
Capital Adequacy		
(i) Equity : Total Assets	12.02	12.03
(ii) Equity : Borrowings	38.67	33.42
(iii) Tier i	21.09	17.63
(iv) Tier ii	22.18	18.66
Liquid Assets		
Liquid Assets Ratio (Minimum 20 per cent)	20.92	21.19

2.1.5 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 had been far in excess and the short term maturity gap up to 3 months 3-12 months and 12 to 36 months, in the year 2010 had been Rs.1,502 million, Rs.3,370 million and Rs. 18 million respectively. Details are given below.

	0-3 Months	3 -12 Months	1 -3 Years	3- 5 Years	Over 5 Years	Total
	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million
Assets						
Interest bearing	1,930	1,202	2,493	2,308	6,032	14,492
Non-Interest bearing	546	58	21	5	778	882
Total	2,476	1,260	2,514	2,313	6,810	15,374
Liabilities						
Interest bearing	3,514	4,455	2,269	674	3,419	14,333
Non-Interest bearing	464	175	263	29	110	1,041
Total	3,978	4,630	2,532	703	3,529	15,374
Maturity Gap	(1,502)	(3,370)	(18)	1,610	3,281	

The following observations are made in this connection

- (i) Out of total customer fixed deposits of the Bank, more than 65 per cent is owned by 11 depositors as at 31 December 2010, and it could adversely affect the liquidity and the going concern of the Bank.
- (ii) The acquired lands of the Bank remaining unsold over a long period of time

2.1.6 Transaction of Contentious Nature

The following observations are made

- (a) When making purchases it is required to call minimum three quotations from suppliers, but audit test check revealed that purchases valued at Rs. 1,439,130 had been made by calling for only one quotation in three instances.
- (b) The Bank had purchased 2,600 wrist watches (gift items) valued at Rs.990,080 during year 2009, but evidence to ensure whether quotations were called for was not made available . Further Bank had purchased 1,977 wrist watches valued at Rs. 841,221 from the same supplier despite the 767 damaged wrist watches of the previous supply.

2.1.7 Management Inefficiencies

The following observations are made

(a) Thilina Tharu Art and Essay Competition

With the objective of mobilizing long term low cost funds the Bank had conducted the “Thilina Tharu Art and Essay Competition” during the period from July 2009 to September 2009 on the commemoration of the “World Habitat Day” to increase children’s savings and increase awareness of the Bank among school children. The following observations are made in this connections.

- (i) Though the above program was carried out during 2009, it was not included in the Marketing Plan for 2009 and the budget.
 - (ii) The Bank had spent a sum of Rs. 2,182,300 in conducting the above competition to increase children’s savings. But the actual deposit base had increased only by Rs. 4,579,161 and it was observed that the promotions had not been effective.
- (ii) Though the Bank targeted to increase the customer base by 100,000, the actual increase had been only 5,962 customers. Further the Bank expected to attract deposits from profitable customers. But the deposits of 16 Branches out of 25 Branches per head had been below Rs. 1,000.
- (b) It was observed that 846 Gents watches valued at Rs. 369,533 and 1,100 ladies watches valued at Rs. 455,840 remained in the stores without being issued to the customers.

2.1.8 Human Resources Management

According to the information made available, the particulars of cadre and the cost per employee for the year under review and the preceding year were as follows.

Category of Staff	Actual Cadre		Total Personal Emoluments		Cost Per Employee	
	2010	2009	2010 Rs.	2009 Rs.	2010 Rs.	2009 Rs.
Executives	200	201	190,919,241	129,162,692	954,596	642,600
Banking Assistant and Allied staff	93	93	59,536,146	30,672,109	640,173	329,807
Others	148	76	23,016,000	13,832,520	155,514	182,006
Total	441	370	273,471,387	173,667,321	620,117	469,371

3 Systems and Controls

Deficiencies observed in the systems and controls during the course of audit were brought to the notice of the Chairman of the Bank from time to time. Special attention is needed in respect of the following areas of control.

- (a) Procurement
- (b) Fixed Assets / Inventories and Stores Management
- (c) Loan Administration
- (d) Publicity and Promotional Expenses
- (e) Training Programmers and Workshops
- (f) Sale of Acquired Properties.

