

Lankaputhra Development Bank Limited – 2017

The audit of financial statements of the Lankaputhra Development Bank Limited (“the Bank”) for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

This report is issued in pursuance of provision in Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board’s Responsibility for the Financial Statements

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

1.3 Auditor’s Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessment, the auditor considers internal control relevant to the Bank’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Lankaputhra Development Bank limited as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Emphasis of Matter

Without qualifying my opinion, I draw your attention to the note No.15 to the financial statements which show fixed deposit investments represent 56 per cent of the total assets of the Bank. The loans and advances represent only 44 per cent of the total assets. The Bank has invested a larger proportion of its money in fixed deposits at a risk free interest rate without granting loans to its customers. This is contradicted with the primary objective of the Bank which assist in the promotion, establishment, expansion, modernization and development of the industrial, agriculture, commercial, construction and other enterprises.

2.1.1 Report on Other Legal and Regulatory Requirements

(i) As required by section 163 (2) of the Companies Act No.07 of 2007, I state the followings,

a. The basis of opinion and scope and limitations of the audit are as stated above.

b. In my opinion:

I have obtained all the information and explanation that were required for the audit and as far as appears from my examination, proper accounting records have been kept by the Bank.

The financial statements of the Bank comply with the requirements of Section 151 of the Companies Act, No.07 of 2007.

(ii) These financial statements had been presented the information required by the Banking Act No.30 of 1998 and subsequent amendments.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standard 18

As per the Paragraph 30 of the standard, interest income shall be recognized by using the effective interest method. Contrary to that, the Bank has recognized the lease interest income on cash basis in the Financial Statements.

2.2.2 Accounting Deficiencies

- i) Differences of Rs.6,786,989 had been observed between the balance of the physical verification records and the balance of the general ledger for the consumables, stationaries and promotional items at head office as at 31 December 2017.
- ii) An unreconciled credit balance of Rs.5, 244,224 had been appeared in the unidentified customer deposit account without crediting the relevant customer's account. Total aggregated unidentified customer deposits from 2008 to 2016 were Rs.4, 644,022 and during the year 2017 another Rs. 600,202 was credited to that account.
- iii) Cash and cheque worth of Rs.1, 470,151 which had directly received since the year 2014 to the year 2017 to accounts maintained by the Bank in external banks had not been adjusted to the cash book of the Bank even up to 31 December 2017.
- iv) Correction credit entries worth of Rs.1, 180,599 relating to cheque return charges, transfers, error postings for the period of last four years period had not been adjusted to the cash book even up to 31 December 2017.
- v) payable balance of Stamp duty amounting to Rs.1,532,416 had been set off by the value of other assets. Due to this, value of assets and liabilities had been understated by the same amount as at 31 December 2017 in the financial statements.
- vi) Audit fees had not been accrued for the financial year 2017.
- vii) The long outstanding credit balances and debit balances amounting to Rs. 21,711,204 and Rs.2,564,854 respectively which had been brought forward from the year 2008 to the year 2016 had not been settled even up to the end of the year under review.

2.2.3 Lack of Evidence for Audit

Evidences mentioned against to the following accounts items had not been made available to audit.

Description	Amount	Unavailable Audit Evidence
	(Rs.)	
Consumables, Stationeries and Promotional items in stores of Branches	2,994,757	Physical Verification Records
SME Debtors	1,432,019	Invoices
Refundable fuel deposit	360,427	Deposit Slips
Other Refundable deposit	253,810	Deposit Slips, Schedules

2.3 Non-compliances with Laws, Rules, Regulations, and Management Decisions.

The following non compliances were observed.

Reference to Laws, Rules Regulations etc.	Non-compliance
(i) Banking Act No.12 of 2007 Section 3 (2)	Although the Board of Directors (Board) should consist with minimum number of 7 members, the board of directors of the Bank had consisted with only 6 members including the chairman.
(ii) Government Procurement Guideline 2006	
(a) Section 4.2.2 and 4.2.3	Procurement Time Schedule for the year 2017 had not been prepared by the Bank.
(b) Section 2.7.5	The members of the Department Procurement Committees (DPC) had been appointed by the Bank contrary to the requirements of the Section.
(c) Section 5.3.1	As per the terms of the Section, bidding documents should be issued according to the format of the publication No. PA/SBD of National Procurement Agency for national shopping. However the Bank had not complied with that requirement.
(d) section 6.3.3.b	Bids had been opened in a delay of 3 days after the closing of bids when procuring new year compliments and note counting machines.

- (e) Section 8.9.3 Formal agreement had not been signed between the selected bidder and the Bank for contracts valued at Rs. 3,480,000, Rs. 1,634,880 and Rs. 1,292,948 respectively, when procuring fire wall solution, windows license and printing annual report 2016.
- (f) Section 5.4.4 The bank had been paid 50 per cent advance payment, without taking advance payment guarantee when procuring fire wall solution and annual report 2016.
- (g) Section 5.4.8 Performance security had not been obtained for safeguard the entity against nonperformance of contract when procuring fire wall solution.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Bank for the year ended 31 December 2017, had resulted in a pre-tax net profit of Rs.298, 196,538 as compared with the corresponding pre-tax net profit of Rs. 258,665,059 for the preceding year, thus, indicating an improvement of Rs.39, 531,479 in the financial results for the year under review. Increase in interest income on leases by Rs.60,517,918 during the year under review and increase in interest income on investments by Rs.59,564,837 had mainly affected to the above improvement.

After considering the adjustment of personal emolument, tax expenses and depreciations to the financial result, the value addition of the Bank for the year under review was Rs.564 million as compared with the corresponding value addition of Rs.488 million for the preceding year. Further, the value addition of the Company had improved by Rs.76 Million.

3.2 Analytical Financial Review

According to the information made available, 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 8.51 per cent and net profit ratio of 35.74 per cent had been reported in the year under review as compared with the average licensed specialized bank (LSB) ratios of 3.76 per cent and 9.3 per cent respectively.

- ii) Interest cost on interest income ratio reflecting 8.86 per cent which is far behind the average LSB ratio of 66.13 per cent.
- iii) The Bank had recorded 3.34 per cent return on average assets which is above the sector ratio of 1 per cent. However, return on equity is well behind than the sector ratio
- iv) High Non-performing loan (NPL) ratio of 37.2 per cent had been observed as at 31 December 2017 which is far above the LSB average ratio of 3.22 per cent.
- v) Total Capital Adequacy Ratio of the Bank is 83.96 per cent as at 31 December 2017 which is excessively high level than the minimum requirement of 11.25 per cent.
- vi) The Liquid assets ratio of the Bank was further increased to 1,429.62 per cent as at 31 December 2017 as compared with the minimum requirement of 20 per cent.

4. Operating Review

4.1 Performance

4.1.1 Planning

A corporate plan had not been prepared by the Bank due to the expectation of merger with Pradeshiya Sanwardhana Bank.

4.1.2 Operating and Review

The actual performance of the Bank against Key Performance Indicators set out in business plan for the year 2017 is summarized below.

- (a) Although the Bank had planned to Increase the loan portfolio of the Bank up to Rs.4, 533 million, the Ministry of Finance had instructed to limit the total loan portfolio of the Bank to Rs.4, 200 million as at end of the financial year 2017. However, Gross Loans and Advances of the Bank as at 31 December 2017 was Rs.4, 037 million. Therefore the Bank had failed to achieve the target by Rs.163 million.
- (b) The Bank had planned to increase the pawning portfolio of the Bank up to Rs.66 million However the pawning portfolio of the Bank as at 31 December 2017 was Rs.35 million which is less than the target by Rs.31 million. As per the Bank's explanation, the Bank was unable to achieve the target due to instructions given by the Ministry of Finance to limit the outstanding balance of loan portfolio to Rs.4, 200 million.
- (c) Although the Bank had planned to increase the fixed deposits of the Bank up to Rs.406 million, the fixed deposit amount of the Bank as at 31 December 2017 was Rs.87 million which represents only 21 per cent of the annual target.

- (d) Although the Bank had planned to increase the saving deposits of the Bank up to Rs.317 million. The saving deposit amount of the Bank as at 31 December 2017 was Rs.293 million which was less than the target by Rs.24 million.
- (e) Although it had been planned to reduce the Non Performing Advance (NPA) balance to Rs.1, 091 million the actual balance stood at Rs. 1,478 million as at 31 December 2017. The Non Performing Loan ratio as at 31 December 2017 was 36.6 per cent which is excessively higher than the annual target.
- (f) Eventhough the Bank had planned to establish link with educational institutions and sign MOUs to promote Education Loan Schemes, no MOUs were signed between the Bank and educational institutions. Further the target loan amount was Rs.50 million. However, only one loan of Rs.5 million had been granted in 2017.
- (g) The Bank had planned to lend to Micro Finance Institutions as innovative investment and the target loan amount was Rs.1, 250 million in 2017. However only two loans worth of Rs.300 million had been granted in 2017.
- (h) It had been planned to grant credit facilities to dairy farmers for cultivation of vegetable and fruits. It was targeted to grant Rs.100 million loan to 100 customers. However loans amounting to Rs.71.42 million had been granted to 123 customers under this scheme. The Bank was able to achieve 71 per cent of the target.
- (i) It had been planned to promote tourism industry by granting credit facilities and the target loan amount was Rs.500 million. Nevertheless loans amounting to Rs.109.6 million had been granted for 22 customers in 2017.

4.2 Management Activities

The following observations are made.

- i) Hambanthota building had been rented out for doctor's quarters since 01 August 2014. However the lease agreement had not been signed between the Bank and the Director General of the District Hospital even up to 20 July 2018, the date of audit.
- ii) Although the leasing payment for the vehicle which had been acquired by the Bank under leasing facility, had been completed on May 2011, an over payment of Rs. 749,812 made by the Bank had not been recovered even up to 20 July 2018, the date of audit.
- iii) A sum of Rs.1, 921,014 receivable as interest on senior citizen fixed deposits relating to first, second and third quarters of the year 2017 had not been received from General Treasury up to 20 July 2018, the date of audit.

- iv) Ten vehicles and twenty two motor bikes which had been used by the Bank under operating lease had been still remained in the Bank and sums of Rs. 56,000 and Rs. 123,200 had been taken in to account as the cost in August 2013.
- v) Board meeting minutes had not been maintained by the Bank in a proper and detailed manner. Therefore the information relating to the decision taken by the Board could not be verified in audit.
- vi) Although the agreement relating to supply of security service to the Bank had been expired on 31 December 2016, the Bank had not taken actions to renew the agreement with the relevant authority even up to 20 July 2018, the date of audit.
- vii) The janitorial service agreement signed between the Bank and Abans Environmental Services (Pvt) Ltd had been expired on 14 May 2013 Even though the company provides the services up to now, the agreement had not been renewed up to 20 July 2018, the date of audit.
- viii) A service provider had been selected for tea making function of the Bank at a monthly cost of Rs. 110,589 by exceeding the approved limit of the Board of Rs. 100,000. Further an agreement had not been signed between the Bank and the service provider and a sum of Rs. 5,074,737 had been paid for the year 2017.
- ix) Although a notice had been issued by the Road Development Authority for removing a part of the building of which the Polonnaruwa Branch was conducted, the Branch is still operating in the same premises without taking actions to move to a new location.

4.3 Operating Activities

Following observations are made in this regard.

- i) The Bank had invested money represent 56 per cent of the total assets of the Bank in fixed deposits of other Banks without granting loans to its customers whilst the loans and advances represent only 44 per cent of the total assets. This is contradicted with the primary objective of the Bank to be assisted in the promotion, establishment, expansion, modernization and development of the industrial, agriculture, commercial, construction and other enterprises.
- ii) Out of the total interest income of Rs.834 million, interest income earned through granting loans and advances was only 49 per cent or Rs.405 million for the year 2017. As well the foreign currency gain earned through revaluation of US dollar loan and deposit was Rs.12 Million. Without having the above income, the Bank may have been sustained an operational loss of Rs.62 million

- iii) Although the loans and advances issued by the Bank as at the end of the year was Rs. 4,037 million, the value of deposit as at the date was Rs. 403 million. The deposit base of the Bank was very marginal, which represents 10 per cent of gross loans and advances.
- iv) The total outstanding loans and advances as at 31 December 2017 was Rs. 4,037 million and out of that Rs.1, 478 million or 36.6 per cent were categorized as non-performing.

4.4 Underutilization of Funds

According to the meeting held in Department of Development Finance on 11 October 2013, Rs.200 million had been given by the government to Lankaputhra Development Bank as a guarantee for small and medium entrepreneur loans. In addition, the government had been clearly mentioned that Rs.200 million should be invested in Pradeshiya Sanwardhana Bank at the rate of 7 per cent per annum. However evidences had not been made available to audit to confirm that those money had been invested in the Pradeshiya Sanwardhana Bank as a guarantee and no such a small and medium entrepreneurs loan scheme was in existence.

4.5 Staff Administration

- i) Major vacancies in key managerial positions such as chief risk officer, head of internal audit and head of human resource were observed.
- ii) A recruitment procedure was not available for selecting and appointing Key Management Personnel.
- iii) Updated and approved Succession Plan was not available for the Bank which provides succession arrangements for retiring key management personal.
- iv) Performance evaluation sheets of employees had not been evaluated by the human resource department.
- v) Copies of the investigation reports and conclusions thereon of particular employees have not been available in their personnel files.
- vi) Even though 6 posts of drivers were vacant according to the approved cadre, it was observed that 12 persons were deployed as drivers in the Bank as at 31 December 2017.
- vii) The Bank had assigned various other duties for the drivers except to their normal duty and in some instances the designations had been changed from “Driver” to other categories.

4.6 Market Share

Information relating to the market share of the bank for 05 years are given below.

Year	Deposits and Loans and Advances				Market Share	
	Deposits		Loans and Advances		Deposit %	Loan %
	The Bank Rs. Million	Other Banks Rs. Million	The Bank Rs. Million	Other Banks Rs. Million		
2017	403	974,574	4,037	639,706	0.04	0.63
2016	421	846,145	3,676	533,230	0.05	0.69
2015	520	764,155	3,334	456,961	0.07	0.73
2014	380	709,671	2,732	440,670	0.05	0.62
2013	229	617,081	2,422	347,117	0.04	0.70

According to the above details it was observed that the market share of the Bank has decreased by 20 per cent based on deposits and 9 per cent based on loans and advances compared to the previous year.

5. Sustainable Development

5.1 Achievement of Sustainable Development Goals

Every public institution should function in accordance with the 2030 Agenda for Sustainable development adopted by the United Nations and the Lankaputhra Development Bank Limited had not aware as to how to act with respect of activities under their purview for the year under review.

6. Accountability and Good Governance

6.1 Budgetary Control

Favourable and unfavourable variances ranging from 5 per cent to 79 per cent had been observed between the budgeted and actual income, expenditure, assets and liability items. Therefore it was observed that the budget had not made use of as an effective instrument in management control.

6.2 Unresolved Audit Paragraphs

As pointed out in 2015 audit report a difference of Rs.6, 826,769 was remained between the general ledger value and value according to the stock verification sheet. This matter had not been resolved up to now and a difference of Rs. 6,786,989 was observed between the value of the general ledger and value of stock verification sheets.

7. **Systems and Controls**

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

Areas of Control	Observation
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Accounting	<ul style="list-style-type: none">– Clearance of long outstanding credit and debit balances not being done.– Posting of transactions into the correct account not being done.– Accurate calculation of VAT on financial services and NBT not being done.– Reconciliation had not been carried out to reconcile the inventory difference between the ledger balance and physical verification record balance.
Loan Administration	<ul style="list-style-type: none">– Strict compliance with the introduced procedures had not been observed.
Operational system	<ul style="list-style-type: none">– Adherence with stipulated procurement guidelines had not been observed.– Actions had not been taken to strengthen the controls in the system of the Bank.