

## **Pradeshiya Sanwardhana Bank - 2017**

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The audit of financial statements of the Pradeshiya Sanwardhana Bank (“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 read in conjunction with Section 13 (1) of the Finance Act, No. 38 of 1971 and Section 33 of the Pradeshiya Sanwardhana Bank Act, No 41 of 2008. This report is issued in pursuance of provisions in Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

### **1.2 Board’s Responsibility for the Financial Statements**

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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**

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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**

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### **2.1 Opinion**

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

### **2.1.1 Report on other Legal and Regulatory Requirements**

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These financial statements had been presented the information required by the Banking Act, No. 30 of 1988 and subsequent amendments thereto.

### **2.2 Comments on Financial Statements**

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#### **2.2.1. LKAS/SLFRS – Sri Lanka Accounting Standards**

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The following observations are made.

- (a) According to LKAS 37 – Provisions, Contingent Liabilities and Contingent Assets a liability is a present obligation which certain about timing and amount of the payment. However, contrary to the Provisions of the Standard, the Bank had recognized Rs.15,330,707 as liabilities under other overhead expense payable in 02 instances where the expected Programs were not implemented during the year under review.
- (b) The deposits totalling to Rs.2,966,135 and loans totalling to Rs.4,496,180 had not been recognized and disclosed as transactions with related parties in terms of the Provisions of the LKAS 24 – Related Party Disclosures.

#### **2.2.2 Accounting deficiencies**

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The following observations are made.

- (a) A cheque valued at Rs.9,000,000 deposited by a customer on 29 December 2017 as a fixed deposit was realized on 03 January 2018 and it was recognized in the year under review. Accordingly, Fixed deposit value had been overstated by that amount and the interest there on amounting to Rs.13,870 had been over accrued in the statement of financial position.
- (b) The PAYE tax expense of Rs.11,162,064 for the month of December 2017 relevant to Sabaragamuwa Province had not been accounted. Due to this, the PAYE tax expense and relevant liability had been understated by the same amount.
- (c) Withholding Tax Payable on interest as at 31 December 2017 had been overstated by Rs.6,616,670 due to erroneous calculation of Withholding Tax from customers' interest income.
- (d) The VAT Expense for the year under review and VAT payable balance as at 31 December 2017 had been understated by Rs.3,820,897 due to erroneous calculation of VAT on financial services.

### 2.2.3 Accounts Payable

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The following observations are made.

- (a) It was observed that, the VAT payable balance amounted to Rs.7,295,193 was remaining since year 2016 without being remitted.
- (b) The aggregated creditors balance in Head Office and 02 branch offices in North Western Province and Uva Province was Rs.95,188,392 representing 57 per cent from total creditor's balance of Rs.167, 509,776 as at 31 December 2017. It was observed that 79 per cent of the above balance remained in the accounts since over 1 year period without any settlement.
- (c) Though the interest had continuously been accrued on 02 loans obtained from the Mahawelli Athority on 01 April 2002, the Bank had not taken steps to pay any interest up to 31 December 2017. The total accrued interest as at 31 December 2017 was Rs.36,764,636 and out of that, Rs.33,468,491 was as at 31 December 2016.
- (d) According to the agreement between the united Nation's Development Programme (UNDP) and then Ruhunu Development Bank, UNDP had provided a loan as a guarantee fund for the loans to be issued by the Bank. However, due to weaknesses identified in the Project the UNDP had stopped the Project and informed the Pradeshiya Sanwardhana Bank in the year 2012. At the meeting held on 30 April 2013, both parties had agreed to return the funds and interest in 03 step approach. However, no steps had been taken by the Bank to settle the funds and the interest thereon. Accordingly, the payable balance of the guarantee fund and interest payable as at 31 December 2017 was Rs.11,003,743 and Rs.20,719,172 respectively.

### 2.3 Non – compliance with Laws, Rules, Regulations and Management Decisions, etc

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The following non-compliances with Laws, Rules, Regulations and Management Decisions were observed.

<b>Reference to Laws, Rules Regulations etc.</b>	<b>Non-compliance</b>
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(a) Banking Act, Directions No.01 of 2016	The Bank had failed to maintain the minimum Capital Adequacy Ratio of 10 per cent for the second quarter of 2017 and stood at 9.26 per cent as at 30 June 2017. The ratio stood at 8.67 per cent in the third quarter of 2017 though the minimum requirement was 11.25 per cent.

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| (b)  | Section 114 of the Inland Revenue Act, No. 10 of 2006, Paragraph 2 of Public Enterprises Circular No. 03/2016 dated 29 April 2016 and paragraph 8.7 of Public Enterprises Circular No. PED/12 dated 02 June 2003 | The Bank had paid PAYE tax totalling to Rs.118, 496,598 to the Department of Inland Revenue for the year under review from its own fund without deducting PAYE tax from employees emoluments in terms of the Provisions of the Act and the Circulars.   |
| (c)  | Public Enterprises Circular No. PED 2/2015 dated 25 May 2015   | Contrary to the circular, a mobile phone for the Working Director costing Rs.98,900 had been purchased by using Bank's fund.  |
| (d)  | Bank's Circulars   |   |
| (i)  | Finance Circular No.2016/32 dated 09 December 2016   | The payment vouchers should be certified by two officers from Office Grade 3 III to 3 I and Office Grade II or above before making payments. However, at the Sample audit carried out, It was observed that, 10 payment vouchers amounting to Rs.15,436,719 had not been certified by an officer grade II or above. |
| (ii) | Administration Circular No.2010/22 dated 28 December 2010  | When granting staff loans, one per cent of the loan should be deducted and remitted to the Head Office to be credited to Staff Loan Assurance Fund. However, Rs.1,713,496 was remained in branch accounts as at 31 December 2017 without remitting to the Head Office.  |
| (e)  | Bank's Procurement Manual  |   |
| (i)  | Section 5.4.6  | A performance security of minimum 5 per cent from the contract value had not been obtained for 03 works contracts.  |
| (ii) | Section 8.9  | Formal contracts had not been signed in 05 instances for contracts which exceeded the value of Rs.250,000.  |

### **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 after-tax net profit of Rs.1,283,929,506 as compared with the corresponding after-tax net profit of Rs.641,288,212 for the preceding year, thus, indicating an improvement of Rs.642,641,294 in the financial results for the year under review. Increase in interest income on loans and advances by Rs.4,573 million during the year under review which is followed by increase in loans and advances by Rs.22,222 million and Increase in interest income on fixed deposits by Rs.2,179 million which is followed by increase in fixed deposits by Rs.7,844 million as compared with the preceding year were the main reasons attributed for this improvement.

In analyzing financial results in preceding 04 years and the year under review, after tax net profit of Rs.191,704,369 in the year 2013 had become a after tax net Profit of Rs.1,283,929,506 in the year under review. After adjusting Personnel emoluments, depreciation and taxation, the value addition of the Bank was Rs.8,579 million. The value addition of the preceding year was Rs.7,015 million.

## **3.2 Analytical Financial Review**

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### **3.2.1 Accounting Ratios**

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

- (a) A high net interest margin of 6.45 per cent was observed for the year 2017 as compared with the Average Licensed Specialized Bank Ratio of 3.2 per cent.
- (b) The staff cost to operating expenses of the Bank for the year 2017 was 72.70 per cent as compared with the sector ratio of 54.4 per cent.

### **3.2.2 Liquidity Gap of the Bank**

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Analysis of financial assets and financial liabilities by remaining contractual maturities as at 31 December 2017 revealed that, the total financial liabilities up to 3 months, 3-12 months and over 5 years were far in excess over total financial assets and the liquidity gaps were Rs.5,042,356,201, Rs.11,007,939,222 and Rs.18,145,882,193 respectively.

## **4. Operating Review**

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### **4.1 Performance**

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#### **4.1.1 Operations and review**

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- (a) According to the Pradeshiya Sanwardhana Bank Act, No. 41 of 2008, the main objective of the Bank is to facilitate the overall regional economic development of Sri Lanka by promoting the development of agriculture, industry, trade, commerce, livestock, fisheries activities and empowerment of women by granting financial assistance to Micro Finance Institutions and Small and Medium Scale Enterprises.

The following observations are made on the performance of the Bank in achieving the above mentioned objective during the year 2017.

- (i) It was observed that only 50 per cent from the total loan target of Rs.125,552 million for the year 2017 had been focused on the specially recommended areas such as Agriculture, Industry, Trade & Commerce and Transport by the Pradeshiya Sanwardhana Bank Act and the Same percentage from the actual loan granted had been granted to those areas.

- (ii) The Bank had targeted and granted 27 per cent and 25 per cent of total loans respectively for the area of housing which was not specially recommended by the Act.
- (b) Cost to Income and Return on Equity had been adversely varied by 8.6 per cent and 22 per cent respectively during the year under review when compared to Corporate Plan of the Bank.
- (c) The total gross loans and advances as at 31 December 2017 was Rs.130,325 million and out of that, loans and advances aggregating to Rs.4,191 million or 3.22 per cent was in non performing category as at end of the year under review. Further, out of that non-performing loan balance, amount aggregating to Rs.377 million was remained as non-performed as at 28 February 2018 as follows.

Arrears Period	Category	Non performing	Amount as a	Non Performing	Amount as a
		balance as at 31.12.2017	Percentage of total non performing balance	balance as at 28.02.2018	Percentage of Total non-performing balance
		(Rs. Million)	%	(Rs Million )	%
3-6 months	Special Mention Loans	986	23	240	64
6-12 months	Substandard Loans	885	21	23	6
12-18 months	Doubtful Loans	533	13	22	6
More than 18 months	Loss Loans	1,787	43	92	24
<b>Total</b>		<b>4,191</b>	<b>100</b>	<b>377</b>	<b>100</b>

#### 4.2 Management Activities

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The following observations are made.

- (a) The Bank had incurred Rs.637,310 as lawyer fees up to 31 December 2017 on a case filed by the Bank in the year 2003 against a defaulted customer to recover Rs.177,000 from a loan granted to purchase a hand tractor .
- (b) The Bank had paid Rs.1, 500,000 to the Divisional Secretariat of Kegalle in May 2017 for the renovation of two Buddhist Temples under corporate social responsibility programme without an acceptable bills of quantity Prepared by an authorized officer. Further, It was revealed that the Divisional Secretariat had not utilized the funds for the intended purpose and no any follow – up actions had been taken by the Bank on utilization of Bank’s funds.
- (c) In the Progress report dated 19 December 2017, It was mentioned that the construction progress in 09 Schools in Central, Uva, Southern and North Western Provinces as 25 Per cent under Sanitary Facilities Uplifting Programme carried out by the Bank in Collaboration with the Ministry of Education. However, It was Observed that the Construction works had not been Started even up to 24 January 2018.

### **4.3 Operating Weaknesses**

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The following observations are made.

- (a) Interest subsidy for senior citizen deposits, will be reimbursed by the General Treasury upon submission of relevant information within 10 days from end of each quarter. However, the delays of requesting, ranging from 2 days to 26 days were observed. The interest subsidy receivable up to end of the third quarter amounted to Rs.329 million and it had not been received up to 29 February 2018 by the General Treasury.
- (b) Though it was required to remit the staff security deposits collected from staff at the time of their appointments to the Head Office, staff security deposit fund account relating to 6 provinces shows a balance aggregating to Rs.245,151 as at 31 December 2017.
- (c) As per the paper advertisement published on 08 November 2016 for registration of suppliers the Bank should obtain proof for ICTAD registration, audited financial statements for preceding 3 years and CRIB reports from prospective suppliers for being considered for registration. However, the above documents had not been obtained by the Bank.
- (d) Though the City Branch Office-Ratnapura had opened on 01 August 2017, the constructed ATM cubicle had not been occupied up to 28 August 2018 due to unavailability of Air Conditioning System.

### **4.4 Under Utilization of Assets**

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As per the Urban Development Authority Letter No. 10/6/163 dated 21 October 2013, the Bank was granted the approval to construct the Imaduwa Branch on the lease hold land. However, The branch had not been constructed until 28 February 2018. The lease agreement for the above said land also was not available till 28 February 2018.

### **4.5 Human Resources Management**

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The following observations are made.

- (a) The approved cadre of the Bank was 2721 and the existing cadre was 2395. Accordingly, 326 vacancies had been observed as at 31 December 2017.
- (b) One excess staff in senior assistant general manager grade and 45 excess staff in office assistant and labour grades were observed.

### **4.6 Market Share of the Bank**

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The Following observation is made in this regard.

It was observed that, the market share of the Bank had increased from 12.65 per cent to 14.35 per cent or by 13 per cent based on deposits and from 20.27 per cent to 20.37 Per cent or by 0.5 per cent based on loans and advances compared to the previous year.

## **5. Accountability and Good Governance**

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### **5.1 Procurement and Contract Process**

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#### **5.1.1 Weaknesses of the Contract Administration**

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Following lapses were observed in the procurement processes followed by the Bank.

(a) Improvement of interior works and construction of ATM cubicle for Peradeniya Branch.

(i) The lowest bidder had been rejected due to a minor deviation in the bidding documents.

(ii) Though the penalties need to be imposed on late deliveries at a rate of Rs.3,000 per day as per the job acceptance letter, The Bank had not imposed penalties for 28 days late deliveries. However, a Proper contract agreement had not been Signed.

(iii) It was observed that 13 items in the bills of quantity valued at Rs.180, 426 had not been completed by the contractor.

(b) Interior partition works for City Branch Office Rathnapura.

Nine items in the bills of quantity valued at Rs.402,709 had not been completed by the contractor.

(c) Interior partition work and supply of furniture at ground floor of Pradeshiya Sanwardhana Bank Head Office.

(i) Contrary to the executive procurement committee decision on 21 March 2017, extra works valued at Rs.207,703 had been done without obtaining the approval from the head of Human Resources Department.

(ii) Though the penalties need to be imposed on late deliveries at a rate of Rs.3,000 per day as per the job acceptance letter, Bank had not imposed penalties for 32 days late deliveries.

(d) The large contracts which comprise from different components need to be divided into separate slices and packages and procured separately to meet the different market capabilities. However, this had not been complied with in respect of 03 procurements which comprise from different components. Therefore the responded percentage was low.

### **5.2 Budgetary Control**

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Favourable variances ranging from 2 per cent to 54 per cent had been observed between the budgeted and actual income and expenditure items, thus indicating that the budget had not been made use as an effective instrument of financial control.



## 6. **Systems and Controls**

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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.

<b><u>Areas of Control</u></b>	<b><u>Observation</u></b>
(a) Accounting	- Transactions had not been posted into correct accounts. - Failure to settle long outstanding balances. - Weaknesses in controls in the information System of the Bank .
(b) Procurements	- Non Compliances with the Procurement Guidelines.
(c) Loan administration	- Non Compliances with the introduced procedures and failure to recover long outstanding balances.