

Housing Development Finance Corporation Bank – 2018

1.1 Opinion

The audit of the financial statements of the Housing Development Finance Corporation Bank (“Bank”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the statement of income and the statement of comprehensive income, statement of changes in equity and statement of cash flow 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 of the Bank give a true and fair view of the financial position of the bank as at 31 December 2018, and of their financial performance and 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 intend to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing 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 the Bank.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements.

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 throughout 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 override 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 Financial Statements

1.5.1 Unreconciled Control Accounts or Records

Audit Issue	Management Comment	Recommendation
Bonus Payable ledger account (2400130001) balance was overstated by Rs. 4,019,868.	This balance represents the unpaid amount of bonuses for AGM and above grades employees and full amount of bonuses of employees those who have on going disciplinary actions. These bonuses have been paid in 2019 and the over under provision will be adjusted in 2019.	Actions should be taken to correct figures in the accounts.

1.5.2 Documentary Evidences not made available for Audit

Audit Issue	Management Comment	Recommendation
(a) Balance confirmations of Balances due to other institutions amounted to Rs.125,138,187 were not available for audit.	Balance confirmation for LKR 487,180,000 was received from Sampath Bank and submitted to the Auditors after observation. Despite several communication and reminders send to the relevant Parties. No response received so far.	Take necessary actions to provide available appropriate documents to the audit.
(b) Agreement with SuduNelum movement of Borrowings from other institutions amounted to Rs. 500,000 were not available for audit.	Sudu Nelum Agreement cannot be located Agreement not available.	Take necessary actions to make available appropriate documents to the audit.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
The Special Interest Scheme on Fixed Deposits of Senior Citizens subsidy account shows a balance of Rs. 75, 136,400 and out of that Rs.41,186,991 or 55 percent was outstanding for over one year without being reimbursed from Government.	<u>Deposit Interest CBSL Subsidy Account.</u> Received from Central Bank Rs.84,447,037 on 25.04.2019. i.e. receivables up to 31.03.2019	Take necessary steps to recover the outstanding balances without delay.

1.6.2 Payables

Audit Issue	Management Comment	Recommendation
(a) A balance amounting to Rs.19,076,739 was appeared in the "Equal Monthly Installments (EMI) Excess Account" for more than one year without being settled them to the respective customers.	<u>EMI – Excess Account</u> The balance has reduced to Rs.3,308,996 as at 07/10/2019. Actions are being taken to refund the money to the customer on their request or as and when customers are identified by the branches.	Necessary actions need to be taken to repay the excess balances to customers.
(b) The Bank had not taken necessary actions to settle the long outstanding balances of Rs.4,484,532, Rs.2,238,028 and Rs.5,973,695 appeared in Dividend Account, Advance Received on Auction Property and Advance Received in Tendered Account respectively in the General Ledger as at 31 December 2018.	<u>Account Code: 1310190002 – Dividends not Presented</u> These are dividends paid but not presented cheques by the shareholders and appropriate action will be taken in 2019. <u>Account Code: 130170018 – Advance received on Auction Properties</u> Action will be taken in 2019 to clear this balance. <u>Account Code: 1310170007 – Advance Received on Tender Procedure</u> Action will be taken in 2019 to clear this balance.	Necessary preventive action need to be taken to reconcile these accounts and clear long outstanding balances in future.

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

Reference to Non-compliance	Management Comment	Recommendation	
Laws, Rules Regulations etc.			
(a) Section 16(2) of Part IV of the Housing Development Finance Corporation Act, No. 7 of 1997.	Issued capital of the Bank should be Rs.1,000 million. However, stated capital of the Bank as at 31 December 2018 was Rs.962, 092,936.	This is the actual value of issued capital which is approximately Rs.1,000 million.	Necessary action need to be taken to comply with the relevant act.
(b) Direction No. 02/17/402/0073/002 of 17 January 2014 issued by the Central Bank of Sri Lanka (CBSL) in conjunction with the Master Plan on Consolidation of the Financial Sector.	Though the Bank should maintain Rs.5,000 million as its core capital as at 1 January 2018, no action had been taken to adhere with this requirement.	CBSL extended the period till 30.06.2019 to meet this requirement. Bank was able to achieve this requirement before the deadline.	Necessary action need to be taken to comply with the relevant act.
(c) Section 02 of the Banking Act Direction No 05 of 2017 dated 26 October 2017.	Minimum Capital of the bank should Rs.7500 million commencing from 31 December 2020. However, any action had not been implemented to adhere to it.	Since more than 51% shares of the Bank are owned by the Government entities, Treasury has to take initiatives in this regard.	Necessary action need to be taken to enhance the capital requirement of the bank in future.
(d) Government Procurement Guidelines and Public Finance Circular PF/429 (i) dated 4 June 2009	The Bank had used a special Purchasing Manual for the purpose of its procurements without obtaining the approvals from the Director General of Public Finance and the Bank had procured 249 items worth Rs.64 million during the year	The Bank will take necessary steps to redevelop the Procurement manual in line with the guideline of the National Procurement Agency Circular, with outside expert and obtain the approval from the Director General of Public Finance, after approval of the Board.	Take necessary steps to adhere with the cited direction.

2018 based on this unauthorized Manual instated of following the Government Procurement Guidelines.

(e) Public Enterprises Circular No. PED 03/2016 of 29 April 2016

The Bank had paid Pay As You Earn (PAYE) tax amounting to Rs.22,396,702 for the year 2018 out of its own funds on behalf of its employees instead of being deducted from the salaries of the respective employees.

According to the collective agreement, staff payee tax is borne by the Bank. However, we expect to comply with the government circular in near future.

Take necessary steps to adhere with the cited direction.

(f) Public Enterprises Circulars No.1/2015(i) of 27 October 2016 and No. 01/2015 of 25 May 2015

i. Section 02

An officer who is entitled to an official vehicle has the option either to use the official vehicle or to avail monthly transport allowance of Rs.50,000 and monthly fuel allowance applicable to the post. However, in contrary to that, the Bank had excessively paid Rs.355,000 to those entitled officers who have obtained vehicles based on the internal approval granted by the Human Resources & Remunerations Committee.

For all the Sections in this circular, we wish to state that, under section 8 of Housing Development Finance Corporation of Sri Lanka (Amendment) Act (No. 15 of 2003), the Board is the competent Authority to fix and vary the salaries and allowances of the officers of the Bank. Therefore, Audit queries based on PED Circulars are not valid, since an Act of Parliament supersedes directions in circulars.

Take necessary steps for the adherence of cited direction.

ii. Section 3.3

The Bank has paid Same as above.

Take necessary steps for

driver allowance of Rs.622,500 annually in addition to vehicle allowance for four officers who are entitle for official vehicles and the bank had paid this allowance from year 2015 which comprising the total amount of Rs.2,092,500 contrary to the provisions in the Circular.

the adherence of cite direction.

iii. Section 3.1

9,756 fuel Liters amounting of Rs.1,415,234 had been paid in addition to the fuel allowance for sixteen officials, contrary to the provisions in the Circular.

Same as above.

Take necessary steps for the adherence of cite direction.

Although no any approval was given for payment of maintenance cost to the officers who are entitled for vehicle allowance, the Bank had paid amounting to Rs.450,000 for nine officers as maintenance cost during the year under review. Further, the bank had paid this allowances from 1 September 2016 to 31 December 2018 which comprising the total amount of Rs.1,049,999.

Same as above.

Take necessary steps for the adherence of cite direction

(g) Loan Recovery

Manual of the Bank

- i. Section 4.1.1 Capital outstanding Properties vested by the Bank Land value of the property
balance of loans from 1995, which had high should be properly
categorized under Vested demand, have already been evaluated before granting
Properties as at 31 sold. But there are other the Mortgage loans and
December 2018 was properties which are in of steps should be taken to
Rs.34,727,029. Out of poor demand due to recover the outstanding
that 61 percent of vested infrastructure of surrounding balance.
properties equal to area has not been developed,
Rs.21,344,090 were which do not fetch even offers
remained over four years to cover the Bank dues.
period without However, we are waiting in
recovering. anticipation of offers which
will cover the Bank dues as
well.
- ii. Section 4.1.5 Revaluation on Vested The lands cannot be identified Revaluation should be
Properties should be done as the boundary stone have done as per the credit
at least in every 2 years been unidentified as removal. manual.
by an internal value or 4 The valuers unable to identify
years by an external the properties to determine
value. However, Vested the valuation. Hence a re-
Properties related to surveyor of the land has to be
capital outstanding done prior to a valuation. The
balances amounting to total dues will increase when
Rs. 2,789,750 remained the re-surveying cost is
for the period between 4- added.
8 years without being These lands have poor demand
revalued. as they are situated in the
remote areas lacking of
infrastructure facilities etc.
Hence the total dues can't be
recovered by selling the
properties. Offers should be
considered for these properties
provided the re- surveying cost
is borne by the offeror.
- iii. Section 3.4.7 The excess money Borrowers could not be Necessary actions need to
collected by auctioning contacted; still Branch be taken to repay the
the Vested Properties Managers are making every excess money.
should be paid to effort to contact the customers
respective customers. continuously.
However, such excess
money amounting
Rs.576,862 had not been
paid to respective 8

customers by the Bank during the year under review.

(h) HDFC Circular No. GCL/2013/108 (revision-05) dated 13.12.2017)

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|-------------------|--|--|--|
| i. Section 1 (8) | The bank should take an action to file case when non-performing loans days past due exceed 195 days. However, sample test carried out in relating to three branches it was observed that the bank had failed to file cases against the 327 customers whose capital outstanding loan balance was Rs.44,328,836 as at 31 December 2018 and it was 58.89 per cent from original loan value disbursed. | The target dates given under GCL/2013/108 (revision 05) for filing cases and parate execution are based on the behavior of average customers / loans. However time taken for filing cases and parate execution may vary depending on the time taken for previous recovery steps.
Eg: Some customers agree to settle the dues, so the bank has to wait until they pay as agreed
In some instances Mediation Board take excessive time to issue non-settlement certificates
Legal recovery steps and parate execution process have now been initiated on the loans identified in the Audit query. | Necessary actions need to be taken to get legal actions as per the circular |
| ii. Section 2 (7) | The bank should take an action to file a case when non-performing loan days past due exceeded 150 days. However, sample test carried out in relating to three branches the bank had failed to file cases against the 197 customers whose capital outstanding loan balance was Rs.186,968,941 as at 31 December 2018 and it represents 89.88 per cent of the original loan disbursed. | Same as above | Necessary actions need to be taken to take legal actions as per the circular |

iii. Section 3 (7)	The bank should take an execute parate action when non-performing loan days past due exceeded 180 days. However, sample test carried out in relating to three branches the bank had failed to take action against three customers whose capital outstanding loan balance was Rs.15,026,071 as at 31 December 2018 and it represents 95.86 per cent of the original loan disbursed.	Same as above	Necessary actions need to be taken to take legal actions as per the circular
(i) Internal Circular No. GCL/2017/223 dated 01 March 2017	Cash received from the customer who does not have any savings account in the bank should be credited to Account Number: 142110000 and it should be immediately cleared. However, Rs.468,409 had remained in the above mentioned account without clearing.	Corrective action has been taken in 2019 with an ALCO decision.	Necessary actions need to be taken to clear the account as per the circular
(j) Internal Circular No. GCL/2017/223 dated 01 March 2017	Rs.1,355,397 valued credit balance shown under Impersonal GL Account No. 1600100001 should be zero as at end of the day. However, this GL balances which had not been zero as at end of the day of 31 December 2018.	As per the design of the system, this account becomes zero daily during the period between LMS EOD and before starting the CBS EOD. Therefore when the balance of the account is checked during that time gap, we can ensure the correctness and completeness of entries passed between LMS and CBS systems.	Should clear the GL balance as at end of the day of 31 December 2018

1.8 Non-compliance with Tax Regulations

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
(a) Inland Revenue Act, No. 10 of 2006 or section 83 of the Inland Revenue Act, No.24 of 2017			
i. Section 114 and Public Enterprises Circular No. PED 03/2016 of 29 April 2016	Employers are required to deduct income tax on employment income of employees at the time of payment of remuneration. Contrary to that the Bank had agreed to add the PAYE Tax of General Manager and Chief Operating Officer into the contract salary, as per the Board Paper No: 30/220/2018 dated 14 June 2018 section 5(b).	According to the above mentioned HDFC Act No.7 of 1997, clause – 14 (1),15(1) and Act No.15 of 2003 clause 8, Board has the authority to decide on the salaries of all staff members including the General Manager.	Take necessary steps to adhere with the cited direction.
ii. Section 19 of the Government Gazette No.1465/20 dated 05 October 2006 and section 10 of the Government Gazette No.1530/13 dated 01 January 2008	The Bank should pay stamp duty to any receipt or discharge of money or property. However, the Bank had failed to pay Rs.3,596,082 as collected stamp duty to the Department of Inland Revenue.	This is not a violation of the regulations of the stamp duty Payment Act. The bank is not liable to pay stamp duty for the loan settlement receipts from customers. The Bank has obtained the opinion of the tax consultants in this respect and as per their opinion; the receipt of the loan repayment is exempt from the stamp duty under item 21 of the Extraordinary Gazette No. 1465/20 dated October 5 th 2006. According to the advices of the consultants, we have taken steps to set off stamp duty over payment against the stamp duty payable on loan disbursements and employee remunerations.	Take necessary steps to adhere with the cited direction

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.565 million and the corresponding profit in the preceding year amounted to Rs.414 million. Therefore, an improvement amounting to Rs.151 million of the financial result was observed. The reasons for the improvement are increase of net interest income by Rs.366 million and increase of net fee and commission income, other operating income by Rs.33 million and Rs.44 million respectively.

2.2 Trend Analysis of major Income and Expenditure items

Description	2018 Rs. million	2017 (Restated) Rs. million	Percentage of Change over previous year
Interest Income	6,679	6,614	1
Interest Expenses	(4,441)	(4,742)	(6)
Net Interest Income	2,238	1,872	19
Net Fee and Commission Income	380	347	9
Other Operating Income (Net)	60	16	275
Total Operating Income	2,678	2,236	19
Impairment Charges for Loans & Other Losses	92	56	64
Net Operating Income	2,586	2,293	12.78
Staff Cost	1,113	941	5
Other Expenses	554	531	3
Operating Profit Before Value Added Tax	918	821	(7)
VAT on Financial Services	289	232	23
Tax Expenses	64	175	(44)
Profit for the year	565	414	4

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 as follows.

Name of Ratio -----	Central Bank Statistics*	2018 -----	2017 -----
<u>Profitability Ratios</u>			
(i) Net Profit Ratio (Percentage)	-	7.92	5.93
(ii) Net Interest Income/ Interest Income (Percentage)	-	33.5	28.29
(iii) Interest cost to Interest Income (Percentage)	-	66.47	71.69
(iv) Return on Average Assets (times)	0.5	1.14	0.87
(v) Return On average Share Holders Fund (times)	7.7	12.56	10.29
<u>Capital Adequacy Ratios</u>			
Tier I (Minimum 7.87%)	13.6	16.41	13.52
Tier II (Minimum 11.87%)	15.7	16.41	13.52
<u>Liquid Assets Ratios</u>			
Liquid Assets Ratio	47.7	20.56	27.58
<u>Other Ratios(In Rupees)</u>			
Earnings Per Share	-	8.72	6.4
Net Assets Per Share	-	73.51	65.39
Market Value Per Share as at end of the Year	-	32.7	47.2

*Source: - Central Bank Financial Sector Statistics 2018-Table 5.4.3 and Annual Report of HDFC-2018

The following observations are made in this regard.

- (a) Net Profit Ratio and Net Interest Income had increased by 33.56 per cent and 18 percent respectively in the year 2018 compared with previous year.
- (b) Return on Average Assets (times) and Return on Average Share Holders Fund (times) had increased by 31 per cent and 22 per cent respectively in the year 2018 compared with previous year.
- (c) Earnings per Share had increased by 36 percent and Market Value per Share as at end of the Year had decreased by 31 percent in the year 2018 compared with previous year.

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.

	2018 -----	2017 -----	2016 -----	2015 -----	2014 -----
Total Loans and Advances of the Bank (Rs. million)	38,812	35,737	31,052	27,316	23,899
Total Loans and Advances of the Market (Rs. million)	712,511	639,706	533,230	456,961	440,670
Market share of the Bank (percentage)	5.45	5.59	5.82	5.98	5.42

It was observed that Market Share of the bank based on the Loans and Advances compared with last four years had been significantly changed.

(b) Market Share based on Deposits

	2018 -----	2017 -----	2016 -----	2015 -----	2014 -----
Total Deposits of the Bank (Rs. million)	37,016	36,655	32,123	28,593	24,479
Total Deposits of the Market (Rs. million)	1,084,612	974,574	846,146	764,155	709,671
Market share of the Bank (percentage)	3.41	3.76	3.8	3.74	3.45

It was observed that Market Share of the bank based on Deposits compared with last four years had been significantly changed.

3. Operational Review

3.1 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
3.1.1 According to the Board Paper No.09/188/2015, the bank had planned to gain potential estimated annual return of 15 per cent from the Ceybank Unit and manage the assets and liability maturity gap. However, no return had been received since the year 2015 for the investment of Rs.25,000,000 in Unit Trust. It was further observed that the market value of the unit trust	This fund is a close-ended investment fund. The fund will be closed for new investors and redemptions through the fund managers are not permitted during the five year period. However the NAV of the fund will be determined by the fund manager and liquidation of the fund will be done at	Investment should be made in line with the investment policy of the bank by paying attention to mitigate the risk of investment

was significantly deteriorating during last 3 years when compare with initial investment price of Rs 10.00 and market rate of the unit trust for the year end was Rs.7.50.

the end of the five year period.

3.1.2 As per the circular No.GCL/2016/210 dated 28 September 2016 the bank had introduced a housing loan facilities to Very Important Professionals (VIP) and 140 loans amounting to Rs.282,985,000 had been granted under this scheme. The seven loans amounting to Rs.21,495,000 or 7.6 per cent had categorized as non-performing as at 31 December 2018. However, there is no any secondary recovery option to the bank due to the unavailability of security. As at 31 December 2018, 37 loans amounted to Rs.57, 166,306 were in arrears and categorized under watch states which have risk of subsequently become to non-performing states.

This scheme was introduced for the first time on 28th September 2016 after getting approval from ALCO at the meeting held on 13th July 2016. Under these scheme 140 facilities, worth of Rs.281 Mn has been granted. By end of 31st December 2018 the capital outstanding balance has come to Rs. 214 Mn and bank recovered Rs. 67 Mn as capital. Out of 140 facilities one facility has been settled in full and 7 cases have gone in to NPL category. Out of 140 facilities 132 cases are in PL category by end of 31st December 2018. Out of 7 NPL loans Bank has taken legal action against 3 customers. This scheme was temporary suspended by the Management of the Bank as per circular No GCL/2016/210 (Revision 01) issued on 2nd November 2017. Out of 140 facilities 122 facilities have been granted to lawyers and bank has more concentrated on this sector due to easy capture within the guideline issued in the circular No. GCL/2016/210.

Necessary preventive actions need to be taken not to occur this type of situations in the future.

3.1.3 Borrowings of the Bank

According to the information made available, debt to equity ratio of the Bank for the year under review and previous four years is as follows.

	2018	2017	2016	2015	2014
Total Borrowings (Rs. million)	6,653	7,917	8,863	9,037	6,213
Shareholders' Funds (Rs. million)	4,757	4,200	3,821	3,364	2,886
Debt to Equity Ratio (percentage)	1.39	1.88	2.32	2.69	2.15

Accepted. This has been due to settlement of debenture borrowings.

Necessary actions need to be taken to maintain debt to equity ratio to an acceptable level.

Total borrowings of the Bank as at the end of the year under review had slightly decreased by 16 per cent over the preceding year as a result of increasing the shareholder's fund by 13 per cent. Debt to Equity Ratio of the Bank had been decreased by 26 per cent as compared with the previous year

3.2 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
Loans and Advances		
<p>a) The total outstanding balance of loans and advances as at 31 December 2018 was Rs.38,812,137,035 and non-performing loans and advances as at that date was Rs.7,939,467,696 or 20.46 per cent of total outstanding balance of loans and advances. However, it was 18.72 per cent and 17.58 per cent as at the end of the year 2017 and 2016 respectively.</p>	<p>We are granting loans for low and middle income customers and they are not serviced by other reputed financial institutions. Most of the loans have been given against property mortgage and EPF balances and recovery of arrears is certain even though it takes time. Now management has taken steps to strengthen the credit evaluation process and funds disbursement process with the intention of reducing the NPL.</p>	<p>Take necessary steps to reduce Non performing Loans and Advances to an acceptable level.</p>
<p>b) Total non-performing loans and advances ratio of 20.46 per cent is significantly higher than the sector ratio of 4.8 per cent.</p>	<p>Same as above.</p>	<p>Take necessary steps to reduce Non Performing Loans and Advances to an acceptable level.</p>
<p>c) 808 loans valued to Rs. 282,272,371 granted during the year under review were transferred to non-performing category due to non-repayment of even a single installment and out of that 798 loans valued to Rs.264,026,888 or 93.6 per cent were represented by EPF Loans.</p>	<p>To solve the problem with EPF NPLs bank has taken steps to educate the customers to pay the installments continuously and the importance of retaining the EPF balance until their retirement to live comfortably in the latter part of the life. Bank has taken steps to get client's salary transferred to bank when granting EPF loans to reduce the NPL as much as possible.</p>	<p>Take necessary steps to recover these loans</p>

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| d) | 280 loans valued to Rs.107,922,503 granted during the year under review were transferred to non-performing category due to non-repayment after settlement of first installment and out of that 274 number of loans amounted to Rs.107,485,490 or 99.6 per cent were represented by EPF Loan. | Same as above | Take necessary steps to recover these loans |
| e) | Total outstanding loans which belongs to the Employee Provident Fund as at 31 December 2018 was Rs. 10,390,878,725 and out of that, a sum of Rs.5,920,202,346 or 56.97 per cent had been categorized as non-performing loans. Accordingly we noticed that non- performing ratio of EPF loan had been increased by 13.3 per cent compared with previous year. | Since the NPLs of EPF loans were in an increasing trend Bank has taken initiatives to centralize disbursements through Credit Administration Division with effect from 1st January 2019, This step has been very successful and therefore expect that NPLs will be reduced in future. | Take necessary steps to recover these loans |
| f) | EPF loans amounting to Rs. 23,613,194 was in arrears for more than 540 days as at 31 December 2018. Although there was a possibility to recover those loans from EPF contributions, the Bank had not recovered those loan balances even up to the end of the year under review. | Out of said Rs.23, 613,194.00 we have already received Rs.11, 440,954 from yearly EPF claim for 2018. Rs. 2,319,169.27 worth of claims were rejected due to submission of F 14 for full settlement and 30% claim from CBSL. That will be received from CBSL during this year (2019).Actions are being taken to recover the balance outstanding. As a recovery step of EPF loans, we have sent a Special letter to all EPF defaulters requesting them to regularize their loan accounts and making them aware to save their EPF balances for their retirement age by making monthly payments. | Take necessary steps to recover these loans |

- g) Micro Guarantor Loans
- i. In the sample audit carried on Micro Guarantor loans in relating to two branches, 19 loans valued at Rs. 1,609,196 out of 49 Micro Guarantor loans valued to Rs. 3,949,601 were in non-performing as at 31 December 2018 and it represents 40.74 per cent of total loans issued by the two branches.
- Most of the micro loans were granted for the purpose of agriculture. Within last two years farmers have to face many difficulties such as bad weather, drop of vegetable price etc. Due to this situation loans were fallen in to arrears. Anyhow branch staff are taking steps to recover those arrears as much as possible. Legal recovery steps have been initiated for the other loans.
- Take necessary steps to recover these loans
- ii. The Ja-ela branch had granted 161 Guarantor Loans valued to Rs. 163,088,000 by for Army officials without verifying repayable capacity of the customer by only getting relevant approval from the employer. Therefore 101 Army loans were turn in to non-performing category as at 31 December 2018 and total outstanding balance was Rs. 122,560,540. Out of that Rs. 99,691,272 was capital outstanding balance which represent 91.24 per cent of the original loan value disbursed. Further satisfactory actions were not taken to recover the outstanding balances from guarantors.
- Actions were initiated to file cases on these loans.
- Take necessary steps to recover these loans
- h) Exclusive loan Centre at Hyde Park Corner was opened on 02 August 2017 for granting loan facilities over Rs. 5 million under Housing Mortgage, EPF and Business Loans category.
- Even though we have planned to disburse Rs. 2,000 million in 2018 we could not achieve the expected targets due to poor customer response and inadequate staff in the Centre for promoting businesses. In this year we re-activated the Centre by recruiting capable, experienced and trained staff to promote EPF and Business loans for high end customers, to achieve the 2019 targets and cover
- Proper actions need to be taken to achieve the target in future.
- i. Even though the bank has spent Rs. 3,151,051 for construction of Exclusive loan Centre, only 10 numbers of loans amounted to Rs. 284.45 million were disbursed up to the date of 30 April 2018. The bank had failed to achieve the

expected targets from the aforesaid Loan Centre.

arrears of previous year's targets as much as possible.

- ii. Even though the targeted Loan amount was Rs.2,000 million in 2018, only Rs.284.45 million or 14 percent has been achieved up to the date of 30 March 2018.

3.3 Procurement Management

Audit Issue	Management Comment	Recommendation
Contrary to Procurement Guideline reference 2.1.1 and Public Finance circular PF/429 (i), the bank had used their own developed procurement manual without obtaining approvals from Director General of Public Finance.	The Bank will take necessary steps to redevelop the Procurement manual in line with the guideline of the National Procurement Agency Circular, with outside expertise and obtain the approval from the Director General of Public Finance, subject to approval of the Board.	Take necessary steps for the adherence of cited direction

3.4 Human Resources Management

Audit Issue	Management Comment	Recommendation
a) According to the section 9.2 (b) and (d) of Chapter 09 of the Public Enterprise Department Circular Number PED 12 dated 02 June 2003, each organization should have an organization chart with an approved cadre and also it should be registered with General Treasury. However, the approval of General Treasury had not been taken by bank.	We are governed by the HDFC Act No.7 of 1997 and amended Act No.15 of 2003. According to that the Board has the authority to approve the organization chart and the cadre. Board approved cadre is available. Please refer minute No. 06/08/HR/2018.	Take necessary steps for the adherence of cited direction
b) Though as per the section 9.3.1 of Public Enterprise Department Circular Number PED 12 dated 02 June 2003, every public enterprise should have schemes of recruitment and promotion for each post and it should be approved by the Board and the appropriate Ministry with the concurrence of the General Treasury,	Scheme of Recruitment has been prepared and it will be submitted to the next Board for the approval.	Take necessary steps for the adherence of cited direction

the bank had not been complied with said requirements.

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| <p>c) As per the Management Service Department Circular No. 03/2018 dated 18 July 2018, all the Ministries and the institutions falling within the scope of the subject of the said Ministries should submit the information on the employees recruited under different categories exceeding the approved cadre of Public Sector Institutions. The bank had failed to submit the aforesaid information to the Line Ministry.</p> | <p>Please refer the HDFC Act No.7 of 1997 clause 14(1) and No.15 (1) and clause 8 of Act No. 15 of 2003.</p> | <p>Take necessary steps for the adherence of cited direction</p> |
| <p>d) The bank had failed to obtained approval for the cadre from Management Service Department in General Treasury.</p> | <p>Please refer the HDFC Act No.7 of 1997 clause 14(1) and No.15 (1) and clause 8 of Act No. 15 of 2003.</p> | <p>Take necessary steps for the adherence of cited direction</p> |

4. Accountability and Good Governance

4.1 Annual Action Plan

Audit Issue	Management Comment	Recommendation
<p>The Bank had not prepared the overall Annual Action Plan for the entire bank by clearly identifying the responsibilities of managers with goals and targets to be achieved during the plan period of year 2017 and 2018, even a plan prepared for marketing division, credit division and financial division.</p>	<p>Though a single document was not compiled as the ‘Action Plan’, Branch targets for the year and Action Plans are for Deposits, Advances, Recoveries, Human Recourses, and Credit are prepared separately. When replying for your query no BAF/C/HDFCB/2018/F/20 following documents were submitted to support our reply. •Branch targets for year 2019. •Action Plan prepared for Deposits, Advances, Recoveries, Human Recourses, and Credit for the year 2019.</p>	<p>Take necessary actions to prepare overall Annual Action Plan for the entire bank.</p>

•Monthly meetings were held with the Regional Managers’ to discuss achievement of targets and strategies.

Minutes of the meeting held on 17th May 2019 with Regional Managers and the Formats which are used by the Regional Managers’ for presenting the performance, as evidence for the same.

4.2 Budgetary Control

Audit Issue	Management Comment	Recommendation
<p>As per the chapter 5.2.4 of the Public Enterprises Circular Number PED 12 dated 02 June 2003, the draft budget should be submitted for the approval of Board of Directors three months before the commencement of the financial year. However, the Bank had not complied with this provision in the year under review and 2019.</p>	<p>The budget is prepared closer to the end of the year, to make it more realistic compared to the actual performances of the previous year. However, in 2018 and 2019 budget preparation, there was a particular delay in approving the budget due to practical situation prevailed for conducting Board Meetings.</p>	<p>Take necessary steps for the adherence of cited direction.</p>