Pradeshiya Sanwardana Bank (Regional Development Bank) - 2012

1. Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Pradeshiya Sanwardana Bank as at 31 December 2012 and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2. Matters of Audit Significance

2.1 Comments on Financial Statements

2.1.1 Matter for Emphasis

Corporate Governance Report of the bank set out on pages 54 to74 in its Annual Report of 2011, was not in consistence with factual finding report of the Auditor General dated 29 May 2012 issued to the Board of Directors of the Pradheshiya Sanwardana Bank.

2.1.2 Unreconciled Differences

Following differences had been identified between balances shown in the general ledger and the confirmations received from the relevant parties with regard to following refinance loan balances as at 31 December 2012.

Description	General Ledger Balance Rs.	Balance Confirmed Rs.	Difference Rs.
A Private Micro Finance Company	107,740,834	132,583,334	(24,842,500)
Uva Provincial Council - Housing Development Fund	2,682,484	2,722,703	40,219

2.1.3 Stock Verification

A difference of Rs. 5,741,751 had been identified between the amount as per general ledger and the physically verified balance of inventory as at 31 December 2012 in Western Provincial Office.

2.1.4 Non – compliance with Laws, Rules Regulations and Management Decisions

Instances of non-compliance observed in audit are given below.

Reference to Laws, Rules, Regulations, etc.	Non – Compliance
(a) Section 30(2)(1) of the Pradeshiya Sanwardana Bank Act, No. 41 of 2008.	The officers and employees appointed under sub section 30(1) shall be remunerated in such manner and at such rate and shall be subject to such term and conditions of service as may be determined by the Board. However, the Bank had paid allowances to the bank officers served in the interview board based on an internal circular which was issued without the approval of Board of Directors.
(b) Section 13(6) of the Finance Act, No. 38 of 1971	A copy of the Draft Annual Report had not been rendered to the Auditor General along with the Financial Statements.
(c) Declaration of Assets and Liabilities Act, No.1 of 1975 as amended by Act, No. 74 of 1988, and the Circular No. 04/1994 dated 18 February 1994 of the Ministry of Justice	The staff officers of the Bank had not submitted the Annual Declarations of Assets and Liabilities.
(d) Financial Regulation No. 685 and Section 1.2.2 (a) of the Procurement Guide lines 2006	Although the Bank shall follow the tender procedure for works and services, the Bank had rented out eight premises for opening new branches and eight premises for branches relocation without following the tender procedures

(e)	Regional Development Bank Office Circular No. 2010/10 (Development Loan)	(i) Even though covering approval from regional office need to be obtained when pawning advances exceeded the approved credit limit of the branch manager, in several occasions the Bank had not complied with the requirement. Eg:- Ruwanwella, Batapola Baddegama, Awissawella and Gampola Branches (ii) Despite the restriction to accept articles which was under 18 karat, it was observed that there were several occasions the Bank had taken pawning article which were under 18 karats. Eg:- Ruwanwella, Batapola, Baddegama, Awissawella and Gampola Branches
(f)	Regional Development Bank Office Circular No. 2011/04 (Financial)	Duty assigned letters had not been distributed to the employees. Eg:- Western Provincial Office

3. Financial and Operating Review

3.1 Financial Results

According to the Financial Statements presented, the operations of the Bank for the year ended 31 December 2012, had resulted in a net profit after tax of Rs. 545 million as compared with the corresponding net profit after tax of Rs. 1,116 million in the preceding year thus indicating a decrease in the net profit after tax by Rs. 571 million, or 51 per cent. According to the budget for the year 2012 the profit after tax was Rs. 1,230 million, and as compared with the corresponding actual profit after tax for year under review indicating a decrease in the profit by 56 per cent.

3.2 Summary of Operating Results

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

Item	2012 Rs. Mn	2011 Rs. Mn
Interest Income	9,049	7,123
Interest Expenses	(4,612)	(3,005)
Net Interest Income	**4,437**	**4,118**
Non Interest Income (Net)	549	456
Total Operating Income	**4,986**	**4,574**
Impairment Chargers for Loans and Other losses	(140)	43
Net Operating Income	**4,846**	**4,617**
Staff Cost	(2,489)	(1,915)
Other Expenses	(865)	(726)
Operating Profit before Value Added Tax	**1,492**	**1,976**
Value Added Tax	(426)	(397)
Profit before tax	**1,066**	**1,579**
Tax Expenses	(521)	(463)
Profit after tax for the year	**545**	**1,116**

The interest income and interest expenses had increased by 27 per cent and 53 per cent respectively in 2012, the non interest expenses had increased by 27 per cent as compared with the preceding year. Personal cost had increased by 30 per cent as compared with the preceding year.

3.3 Cost of funds and yield for the year ended 31 December 2012

	Based on cumulative cost and revenue		
Description	**Average Balance** Rs.'000	**Cost / Revenue** Rs.'000	**Rate** %
Deposits			
Savings	20,116,494	758,256	3.8
Fixed / Certificate of Deposits	30,315,563	3,502,796	11.6
Sub Total Deposits	**50,432,057**	**4,261,052**	**8.4**
Borrowings			
Refinanced Loans	1,881,448	180,144	9.6
Other Borrowings	3,723,106	171,182	4.6
Sub Total Borrowings	**5,604,554**	**351,326**	**6.3**
Cost of Fund on Mobilization	**56,036,611**	**4,612,378**	**8.2**
Other Liabilities	4,397,576	-	-

Capital	1,099,400	104,654	9.5
Reserves	3,209,284	-	-
Less :			
Other Assets	3,559,373	-	-
Financial Cost	61,183,496	3,353,828	5.5
Overhead Costs	61,183,496	186,117	0.3
Total Cost of Funds	**61,183,496**	**8,256,977**	**13.5**
Loan Portfolio	50,433,464	7,854,058	15.6
Investments	10,750,032	1,195,088	11.1
Financial Yield	**61,183,496**	**9,049,146**	**14.8**
Margin	61,183,496	792,169	1.3
Freebased other income	61,183,496	595,603	1.0
Margin	**61,183,496**	**1,387,772**	**2.3**
Tax	61,183,496	946,936	1.5
Net Margin	**61,183,496**	**440,836**	**0.7**

3.4 Significant Ratios

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

Indicator	**2012**	**2011**
	%	%
Profitability		
Net Profit Ratio	5.66	14.65
Net Interest Income/ Interest Income	49	58
Interest Cost to Interest Income	51	42
Overhead Expenditure to Net Interest Income	19	18
Return on Average Assets	1.6	2.9
Earnings per Share (Rs.)	4.96	10.15
(i) Equity : Total Assets	1 : 15.84	1: 14. 16
(ii) Equity : Borrowings	1 : 1.38	1 : 1.22
Capital Adequacy Ratio		
(i) Tier I (Minimum 5 per cent)	10.30	11.84
(ii) Tier II (Minimum 10 per cent)	10.61	12.18

Liquid Assets Ratio		
Liquid Assets Ratio (Minimum 20 per cent)	23.30	19.20

3.5 Maturity Profile of the Bank

Analysis of the profile of the assets and liabilities of the Bank as at 31 December 2012 revealed that the total liabilities were far in excess over assets and the Long term liquidity gap up to 3 to 5 years and over 5 years in 2012 were Rs. 2,352 million and Rs. 8,979 million respectively. Details are given below.

	0-3 Months	3 -12 Months	1 -3 Years	3- 5 Years	Over 5 Years	Total
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
Assets						
Cash and Balance with Central Bank	202,978	-	-	-	-	202,978
Balance with Banks	4,618,376	7,353,728	-	-	-	11,972,104
Financial Assets Held for Trading	-	-	-	-	629	629
Loans and Receivables from Banks	2,108	10,000	-	-	-	12,108
Loans and Receivables from Other Customers	12,693,787	24,868,681	10,742,118	4,595,190	1,835,106	54,734,882
Other Assets	1,275,602	654,379	6,654	-	-	1,936,635
Total Assets	**18,792,851**	**32,886,788**	**10,748,772**	**4,595,190**	**1,835,735**	**68,859,336**
Liabilities						
Payable to Banks	288,993	1,364,277	3,304,658	1,120,702	-	6,078,630
Payable to Other Customers	15,119,623	17,418,164	5,821,619	5,824,531	10,485,933	54,669,870
Other Liabilities	3,382,535	727,620	40,494	1,775	328,432	4,480,856
Total Liabilities	**18,791,151**	**19,510,061**	**9,166,771**	**6,947,008**	**10,814,365**	**65,229,356**
Maturity Gap	**1,700**	**13,376,727**	**1,582,001**	**(2,351,818)**	**(8,978,630)**	**3,628,980**

3.6 Items of Contentious Nature

According to the Pradeshiya Sanwardana Bank Act, No. 41 of 2008, every Deputy General Manager should have a degree from a recognized university with a post graduate qualification or post graduate diploma in a relevant field or have full professional qualifications in banking. However, it was observed that the Deputy General Manager for the human resource development and administration of the Bank had not fulfilled the above requirements. Details are as follows.

(I) He had not possessed the postgraduate diploma in human resource management in Postgraduate Institute of Management of the University of Sri Jayewardenepura as per his application.

(II) Incorrect information had been submitted when publishing the Annual Report of 2011 and also submitted an affidavit with incorrect information to the Central Bank of Sri Lanka.

(III) The Bank had paid a monthly salary of Rs. 125,000 and monthly transport allowance of Rs. 50,000. In addition, his monthly salary had been increased in line with the collective agreement up to Rs. 150,000 with effect from 01 January 2012 and arrears of salary had also been paid to him by the Bank. However, it was observed that he was not bound to the collective agreement as he was recruited on contract basis.

3.7 Loan Administration

Following observations are made.

(a) In certain instances it was observed that motor vehicles which were purchased under staff motor vehicle loans scheme had not been registered with the Bank as an absolute owner.
Eg:- Wayamba Provincial Office, Central Province Office, Gampaha Branch

(b) Staff loans amounting to Rs. 1,217,700 were granted by the Wayamba Provincial Office which were categorized under non-performing. It was observed that recoveries of these loans were unsatisfactory.

(c) As per Budget proposals of 2003, The Kandurata Development Bank had entered into an agreement with the General Treasury on 1 March 2004 to act the Bank as a participatory lending agency with the objective of solving the housing problem of the persons those who earn up to Rs. 20,000 as monthly income. Under the "Sahana Piyasa Loan Scheme" General Treasury had granted refinance loan amounting to Rs. 67 million with an interest of 06 per cent and the Bank should grant loans to beneficiaries at 9.5 per cent of Interest. Following observations are made in this regard.

(I) The Bank had violated the condition of the above requirements and granted housing loans for bank's staff at an interest rate of five per cent, incurring a loss of interest of one per cent.

(II) According to the board paper dated 29 July 2003, the Board of Directors had agreed to grant up to Rs. 350,000 at 5 per cent of interest rate, additional amount of up to Rs. 500,000 at 7 per cent interest rate and over Rs. 500,000 at 10.5 per cent interest rate. However, the Bank had violated the said conditions and granted loans to staff of the Bank exceeding the above credit limits at a fixed Interest rate of 05 per cent.

3.8 Management Inefficiencies

Following observations are made.

(a) According to Banking Industry Analysis of 2012, The Bank had recorded the highest ratio of the personal cost out of total expenses excluding the interest expenses and fee and commission expenses which is 74 per cent as compared with the Banking Industry Average of 60 per cent.

(b) The Bank had introduced a "Special Savings Certificate" under the promotional campaign for 2012 Sinhala and Hindu new year festival. These saving deposits should be hold for one year at 5 per cent interest rate. However, it was observed that certain branches had not hold these saving deposits for one year of which were not shown in the computer system.
Eg :- Batapola, Baddegama, Gampaha and Ruwanwalla Branches

(c) Under the promotional campaign for 2012 Sinhala and Hindu New year festival, the Bank had collected Rs. 152,136,359 worth of special saving deposits as at 30 April 2012 and had earned a net interest margin of Rs. 10,649,545 as per the information collected by the management. However, the bank had incurred a sum of Rs. 35,391,820 as cost of gift items and Rs. 786,543 on advertising expenses for this campaign.

3.9 Identified Losses

A sum of Rs. 4.588 million had been charged by the Bank of Ceylon as debit tax on the Pradeshiya Sanwardana Bank interbank transactions made during the month of December 2010. This amount had been accounted for as debtors as at 31 December 2011. The Inland Revenue Department had refused to refund this amount and therefore the Bank had written off the above amount against the revenue for the year under review without the approval of the Board of Directors.

3.10 Internal Control

Following observations are made.

(a) Approved and documented internal control procedure manuals over major operational areas were not in operation. The credit delivery, recovery and credit risk management policy and pawning operation regulations were still in draft form.

(b) A Master Procurement Plan for the Bank had not been prepared.

3.11 Delays in Implementation of Core Banking System

An agreement had been signed to implement the Core Banking System with an Indian company on 09 December 2011 at a cost of Rs. 158,091,407. According to the agreement, implementation of the Core Banking System should be completed within six months from the date of the agreement. However the Bank had paid only Rs. 78,706,344 by 31 December 2012 to the software developer as the value of the work completed. It was further observed that all steps in system implementation had shown remarkable delays due to lack of coordination and assistance to the developer by the IT department of the Bank. It was also observed that the performance bond had not been furnished for the audit.

3.12 Weaknesses of the Computer Software

The Bank had introduced on new computer software to few branches for their operations. However it was observed that there were some weaknesses in the system such as reports generation, reports on loan classifications, reports on dormant transfers, generation of management reports etc.

3.13 Performance of the Bank

(a) Deposits

According to the 2012 budget, the Bank had expected to increase their deposit base to Rs. 65,317 million at the end of the year under review. However, the actual total deposits at that date was only Rs. 54,670 million.

(b) Loan Portfolio

According to the budget for 2012, the Bank had expected to grant Rs. 63,439 million value of loans at the end of the year under review. However, the Bank had granted only Rs. 54,735 million of total loans by the end of the year under review.

(c) Financial Investments

In terms of Corporate Plan for 2011-2015, the Bank had expected to invest a sum of Rs. 15,127 million by the end of the year 2012 and anticipated to invest Rs. 13,063 million as per Budget 2012. However, the Bank had invested only Rs. 11,972 million of total investments by the end of the year under review.

4. Systems and Controls

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

(a) Loan Administration
(b) Human Resources Management
(c) Corporate Governance
(d) Pawning
(e) Compliance with Instructions of the Central Bank of Sri Lanka
(f) Core Banking System
(g) Budgetary Control
(h) Staff Cost
(i) Business Promotion Activities