

1.1 Opinion

The audit of the financial statements of the Housing Development Finance Corporation Bank (“Bank”) for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 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 2020, 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
As per the GCL/2017/223 dated 01 March 2017, Inter-System-GL-CBS LMS and Cheque in hands should be zero as at end of the day. However, credit balance of Rs.346,496 and Rs.14,885,183 respectively had remained in the above two accounts without clearing as at 31 December 2020.	These two credit balances were arising from GL Accounts 1600100001 and 1331100001 respectively and reasons are mentioned below. 1600100001- This is due to system recovery timing issue. 1331100001 – This is due to updating of transactions on realization of cheques.	Necessary action need to be taken to amend the relevant circular.

1.5.2 Documentary Evidences not made available for Audit

Audit Issue	Management Comment	Recommendation
Confirmations had not been received for the nine borrowing account balances amounting to Rs.2,149,236,854 as at 31 December 2020.	The process of confirmations for above accounts is directly sending to Auditors without a copy to us. Therefore, reminders sent for confirmations which were not yet received.	Necessary action need to be taken to get conformation from relevant institution timely.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
i. The balances of receivable from Loan Admin Charges for performing and non-performing loans shown in the Other Assets were Rs.632,444 and Rs.22,343,670 respectively and recoverability of Loan Admin Charges for non-performing loans amounted to Rs.22,343,670 was in doubt. However, an impairment provision had not been made in the year under review.	The bank has considered all receivables including loan admin charges for future cash flows when computing impairments. Therefore, adequate provisions have been made for the accounts.	Action need to be taken to provide adequate impairment provision in relation to Loan Admin Charges for performing and non-performing loans
ii. Receivable balances relating to ledger accounts 2400120002 and 2400120001 aggregating Rs. 22,718,751 were remained over a long period and the recoverability and existence cannot be verified due to the unavailability of evidences. Further the impairment provision had not been made in this regard in the year under review.	This concern was accepted and required provisions have been made to the accounts.	Action need to be taken to provide adequate impairment provision.

1.6.2 Payables

Audit Issue	Management Comment	Recommendation
i. There are some GL accounts categorized under other liabilities have long outstanding balances as at 31 December 2020 amounted to Rs.7,555,355 and it was further evidenced that 04 GL account balances present the same amount for more than five years.	These are ongoing accounts and settlement is based on the completion.	Necessary actions need to be taken to clear all long outstanding balances in the future.
ii. The excess loan recoveries amounting to Rs.59,839,762 appeared in the "Payments against Loan" was outstanding as at 31 December 2020 and out of that Rs.6,397,415 had remained for more than 1 year without paying to the respective customers. It was further observed that the excess loan	This is due to moratorium effect and other balances are early collection of EMI balances from the customers.	Necessary actions need to be taken to repay the excess balances to respective customers.

recoveries had increased by 835 percent in the year under review compared with previous year.

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| iii. The Bank had taken deposits from Police Department for granting loans to their employees at an interest rate of 6 percent and 2percent and it was transferred to PHDA Fund from1999. A sum of Rs. 13,576,550 had been remained since 2016 in the Police Housing Development Fund account (1310180001) without reconciling. | Loans granted to Police Officers were already settled. If Police Department agrees to continue the loan scheme, we will continue the fund, if not we will refund the same. | Actions need to be taken to clear the relevant fund to Police Department |
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1.7 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
i. Section 16(2) Part IV of 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 2020 was Rs.962 million. The bank had failed to fulfill the balance capital.	This matter has been discussed at several meetings with Treasury officials and waiting for a favorable answer.	Necessary action need to be taken to comply with the relevant act.
ii. Banking Act Direction No 05 of 2017 dated 26 October 2017 section 02 of the Central Bank	Minimum Capital of the bank should be Rs.7,500 million commencing from 31 December 2020. As per the paragraph 3 of letter dated 16 March 2020 issued by the Governor of Central Bank Sri Lanka, said this requirement is differed until end of 2022. However, the bank was able to raise only up to Rs.5957 million of capital as at the end of the year 2020.	The Bank had made a request for the extension of the deadline for meeting Rs.7,500 million capital requirements. Nevertheless, by the letter issued by the CBSL dated 27 March 2020 (attached) the deadline has been extended up to end of 2022.	Necessary action need to be taken to comply with the relevant direction.
iii. Section 15 (7) of the Pawning Direction issued by CBSL	As per the Pawning Direction, if an article is sold for an amount exceeding the money lent on the security of that article together with interest thereon, the Pawnee shall forth with forgive notice to the	There are ongoing settlement actions taken by the bank and we expect to complete the process in 2021.	Need to follow cited Direction

pawner of that article by registered post to the address stated in the pledge book of the amount for which the article was sold and of the amount lying to the credit of the pawned after deducting the cost of postage and the charges. However, such notices have not successfully been given to the pawners by the bank. It was further observed that excess money amounted to Rs.1,520,408 received from pawning auction had been remained more than one year without returning to the respective customers.

iv. **Loan Recovery Manual**

a) Section 4.1.1

Properties vested by the bank should be sold in an auction within a short period and recover the loan outstanding balance. Contrary to that total outstanding balance (Capital with interest) of the loans categorized under Vested Properties as at 31 December 2020 was Rs.178,297,149 out of that Rs.36,731,157 or 20.60 percent of above balance were remained over five years period.

As per our records 135 no of vested properties worth of capital with interest outstanding balances amounting to Rs.154,856,755.38 available as at 31 December 2020.

According to the new sale of vested property policy, we have sold 21 number of properties related to capital with interest outstanding balances amounting to Rs.21,194,390.35 and out of that properties, 19 no of properties amounted to Rs.3,057,267.38 related to over five year period.

Further, above mentioned Rs.178,297,149 includes Capital, interest and penal charges too.

Land value of the property should be properly evaluated before granting the Mortgage loans and steps should be taken to recover the outstanding balance.

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| b) | Section 4.1.5 | Revaluation on Vested Properties should be done atleast in every 2 years by an internal valuer or 4 years by an external valuer. However, vested properties related to capital with interest outstanding balances amounting to Rs.12,453,423remained for the period between 2-8 years without being revalued as requested. | Avoid unnecessary costs, revaluation of vested properties is done after receiving the tenders and also for potential salable properties. | Necessary action need to be taken to amend the relevant manual. |
| c) | Section 4.1.9 | At the time of obtaining the tender a refundable deposit atleast amounting to Rs.10,000 and a non-refundable tender deposit of Rs.500 should be obtained, if in any case the tender is not approved by the tender board to the tenderer, the tender amount should be returned to the relevant depositors within a reasonable time. However, the bank had not complied with said requirement. The excess money amounted to Rs.7,051,817appeared in the Advanced Received on auction properties for more than one year without paying them to the respective customers. | These are under approval process and after receiving approval, bank will disburse the refundable deposits to the respective customers at least in 2021. | Action need to be taken to repay the excess money to the respective customers. |

v. Internal Circulars for the Gold Loan dated 18 July 2012

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| a) | Section 2.3 | When granting gold loan to a staff member covering approval of the Area Manager should be obtained. However, without getting such approval 115gold Loans amounted to Rs.9,014,950 were granted by a branch. | Covering approval has been obtained for all previous staff gold loan advances and has been updated to date. | Take necessary steps to minimize this type of negligence in the future. |
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b)	Section 16	The insurance policy should cover the value of the gold articles and not the amount advanced. Contrary to that the bank had insured based on the advance granted on gold articles.	Comments noted. Additional Insurance cover will be obtained as and when necessary as per the circular.	Suitable decisions need to be taken to cover the value of gold articles in the future.
vi.	Circular No. GCL/2013/129 (Revision 07) dated 29 June 2017	The branch should obtained an insurance coverage for the palmtop cash collection amounting to Rs.500,000. However, it was observed that the cash collection of the promotional assistants had exceeded the insurance limit in twelve instances in three branches.	Instructions were given to the officers to follow up the manual and monitor in future.	Need to follow cited circular and relevant manual.
vii.	Circular No.GCL/2012/058 (Revision 109) dated 02 May 2019	The interest payable on the early Fixed Deposit withdrawals shall be computed on the basis of the lower of, the published interest rate of the bank applicable to the completed period prevailing at the time of withdrawal or at a rate of 1 percent less than the contracted rate. However, the system does not facilitate in this regard.	Steps were taken to ensure that these were not repeated in the future.	Action need to be taken to facilitate the system.

1.8 IT General Controls

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
Non utilized user accounts It was observed that 37 number of user accounts were not utilized for a long period of time in the Polaris- Core banking system. The bank had failed to take necessary actions to deactivate those user accounts.	Base on management decision, relevant user will be disabled.	Take necessary actions to deactivate user accounts were not utilized for a long period of time.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.708 million and the corresponding profit in the preceding year amounted to Rs.476 million. Therefore, an improvement amounting to Rs.232 million of the financial result was observed. The main

reason for the improvement is the reduction of VAT rate and removal of NBT, ESC and DRL due to the decision made by the Budget Proposal of 2021.

2.2 Trend Analysis of major Income and Expenditure items

Items -----	2020 ----- Rs. Mn	2019 ----- Rs. Mn	Percentage of Change over previous year -----
Interest Income	7,457	7,683	(2.9)
Interest Expenses	(4,475)	(4,783)	6.4
Net Interest Income	2,981	2,900	2.79
Net Fee and Commission Income	303	358	(15.36)
Other Operating Income (Net)	97	49	97.96
Total Operating Income	3,381	3,307	2.24
Impairment Charges for Loans & Other Losses	(326)	(323)	0.92
Net Operating Income	3,055	2984	2.38
Staff Cost	1,174	1,164	0.86
Other Expenses	499	575	(13.21)
Operating Profit Before Value Added Tax	1,381	1,244	11.01
VAT on Financial Services	313	470	(33.40)
Tax Expenses	360	299	20.40
Profit for the year	708	476	48.74

2.3 Ratio Analysis

2.3.1 According to the information made available, some of the important ratios of the Bank for the year under review and the preceding year is as follows.

Name of Ratio -----	Central Bank Statistics* -----	2020 -----	2019 -----
<u>Profitability Ratios</u>			
(i) Net Profit Ratio (Percentage)		9.01	5.88
(ii) Net Interest Income/ Interest Income (Percentage)		39.98	37.74
(iii) Interest cost to Interest Income (Percentage)		60.02	62.26
(iv) Return on Average Assets (times)	0.9	1.21	0.90
(v) Return On average Share Holders Fund (times)	16.7	12.99	9.63
<u>Capital Adequacy Ratios</u>			
Tier I (Minimum 8.5%)	11.8	20.20	19.14
Tier II (Minimum 12.5%)	14.8	20.67	19.14
<u>Liquid Assets Ratios</u>			
Liquid Assets Ratio	60.4	37.20	26.07
<u>Other Ratios(In Rupees)</u>			
Earnings Per Share		10.94	7.35
Net Assets Per Share		89.35	79.11
Market Value Per Share as at end of the Year		36.2	26.00

***Source:** -Central Bank Financial Sector Statistics 2020-Table 4.2 (Provisional Data)

The following observations are made in this regard.

- (a) Net Profit Ratio had increased by 53.23 percent and Net Interest Income had increased by 6 percent in the year under review compared with previous year.
- (b) Return on Average Assets (times) and Return on Average Share Holders Fund (times) had increased by 34 percent and 35 percent respectively in the year under review compared with previous year.
- (c) Earnings per Share had increased by 49 percent and Market Value per Share as at end of the year had increased by 39 percent when 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.

	2020	2019	2018	2017	2016
Total Loans and Advances of the Bank (Rs. million)	42,637	42,360	38,812	35,735	31,052
Total Loans and Advances of the Market (Rs. million)	816,858	760,057	712,511	639,706	533,230
Market share of the Bank (percentage)	5.22	5.57	5.45	5.59	5.82

(b) Market Share based on Deposits

	2020	2019	2018	2017	2016
Total Deposits of the Bank (Rs. million)	47,947	42,504	37,016	36,655	32,123
Total Deposits of the Market (Rs. million)	1,553,621	1,277,529	1,084,612	974,574	846,146
Market share of the Bank (percentage)	3.09	3.33	3.41	3.76	3.80

2.4 Maturity Analysis

Audit Issue	Management Comment	Recommendation
Analysis of Financial Assets and Financial Liabilities by remaining contractual maturities as at 31 December 2020 revealed that Financial Liabilities for months 3-12 was far in excess over total assets, and the liquidity gap was Rs.7,272 million.	This is due to respective contractual maturities of Assets and Liabilities	Take necessary steps to minimize the maturity gap in future.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
Seven fraudulent loans were granted to staffs in an organization by a branch in 2018 and subsequently it had been transferred to non performing category. The outstanding balance as at 31 December 2020 was Rs. 8,250,131.	A complaint has been lodged against customers except loan no. 801650000408 in Special Crime Division in Teldeniya and case is being heard in District Court, Mayiyanganaya regarding this matter.	Suitable actions need to be taken to prevent this type of situations in the future.

3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
i. Even though there is an Investment Property valued at Rs.759.5 million owned by the bank located in the premises of the Building Material Corporation, Sri Sangaraja Mawatha, Colombo 13, the ownership of the property has been transferred to the bank on 31 December 2008, the vacant possession of the land was not handed over to the bank by Building Material Corporation (BMC). In order to obtain the vacant possession of the land the bank had decided to obtain the Writ order decision and accordingly Writ papers filled on 15 August 2017. As per the section 75 (i) (a) and (b) of the Cabinet Decision paper No 18/විවිධ/ (019) dated 31 May 2018, all heads of institute under its purview to refrain from taking legal action against other government agencies for the purpose of resolving disputes between government agencies and should make every effort to	GM/CEO, COO, DGM Legal and AGM HRM visited BMC Chairman and CEO and the present status of the BMC property was discussed. A letter was sent to BMC Chairman requesting to handover the possession to the Bank. No response has been received. Further, our Chairman has sent another letter to the Prime Minister's office. A letter was sent to Additional Sectary Ministry of Housing (HDFC Bank Director) informing the present status of BMC Land and awaiting a response.	Immediate action need to be taken to obtain the vacant possession of the land to the bank

resolve such disputes through negotiation procedures with the assistance of all other relevant authorities. But the bank had failed to obtain the vacant possession through negotiation procedures.

- ii. It was observed that the 52.2 perches land acquired for the purpose of entrance to Investment Property of the bank located at BMC premises was utilized by the people around the land for dump their rubbish and debris. The key of the gate was also handed over to a person who is from Sangaraja Mawatha. The bank had not received any return on the said investment.
- We are keeping this land for funding purpose when we are building a new Head office building or purchase a Head office building.
- Suitable decision need to be taken to get return on the said investment in near future.
- iii. As per the circular No.GCL/2016/210 dated 28 September 2016 the bank had introduced housing loan facilities to Very Important Professionals (VIP) and 140 loans amounting to Rs.282,985,000 had been granted under this scheme. 33 loans amounting to Rs. 52,777,346 or 18.65 percent had categorized as non-performing as at 31 December 2020. However, there is no any secondary recovery option to the bank due to the unavailability of security.
- This loan scheme was introduced in September 2016 for the first time. Majority of clients were Lawyers. At the point of granting the loans, income of Lawyers' has been confirmed by the Bar Association of relevant area, where the Lawyers were working and loans were granted based on these confirmations. Most of the Lawyers were not paying the loan not because of their income but purposely.
- We try our best to recover these loans by getting the support of respective Bar Association prior to take legal actions against the customers. But we have taken legal actions against some customers under Civil Procedure Court and we take same action if we cannot get support of respective Bar Associations. We have temporally suspended this
- Suitable actions need to be taken to prevent this type of situations in the future.

loan scheme at the moment.

- iv. Bank had invested Rs.50.95 million in debenture at the rate of 11.75 percent at the MTD Walkers PLC on 01 October 2018 with one-year maturity period. However, capital of Rs. 50,956,700 and interest of Rs.13,533,630 had not been repaid by the company. Therefore no any returns had been received to the bank even at 31 December 2020.
- This is a defaulted investment and no reschedule was done. However, recovery process is going on by the trustee bank (BOC). Further, as per the SLFRS, the contracted interest should be recognized by the bank and due to the impairment implications, the respective accruals were fully provided for impairment. Therefore, this is not an over/under statements in financial statements.
- Suitable decisions need to be taken not occur this type of situations in the future.
- v. As per the Board Paper No 19/188/2015, the bank had planned to gain potential estimated annual return of 15 percent per annum for the funds and to manage the assets and liability maturity gap accordingly. No any return had been received during the investment period from 2015 to 2020 from the investment amount of Rs.25,000,000 made in Ceybank unit.
- This investment was maintained to resolve the maturity mismatches expecting capital gain at the time of investment. However, the market condition changed thereafter and therefore, the bank could not achieve the original expectations.
- Investment should be made in line with the. Investment policy of the bank by paying attention to mitigate the risk of investment

3.3 Operational Inefficiencies

(i) Loans and Advances –Performing & Non Performing Loans

Audit Issue	Management Comment	Recommendation
<p>a) The total capital outstanding balance of loans and advances excluding EPF as at 31 December 2020 was Rs.28,670 million and non-performing loans and advances as at that date was Rs.5,800 million or 20.23percent of total outstanding balance and which was higher than the sector ratio of 6.8 percent.Following weaknesses were observed in branch audit.</p>		

- i. A branch had granted Rs. 50 million to a customer at a concessionary rate of 9 percent for a period of 5 years with a grace period of 2 years on 13 September 2016. Total outstanding balance as at 31 December 2020 was Rs. 56,969,235. The company had failed to achieve their manufacturing targets as per their project proposal. After obtaining the loan the company had recorded a loss of Rs.23.14 million in the year 2018. Even though the grace period was extended by branch in 2 times and loan repayment period also extended, the customer had failed to repay the loan.
- The Company has been running at a loss after giving the loan due to the failure of achieving expected manufacturing targets and achieving expected export income. Bank has rescheduled this facility twice on request of the customer. It has been planned to take legal action against the company in December 2021 after the Debt Moratorium period granted by CBSL. Letter of Demand has already been sent.
- Project proposal and customer's income sources should be evaluated properly before granting the mortgage loans and steps should be taken to recover the outstanding balance.
- ii. A credit facility of Rs.350 million requested by a customer for working capital requirement was approved at the Special Board Meeting held on 07 June 2019. Accordingly, the branch had granted Rs.100 million and Rs.150 million credit facilities to the said company on 08 July 2019 and 28 October 2019 respectively. Subsequently it had been transferred to non performing category on 07 January 2020 at the early stage of granting. As at 31 December 2020 total outstanding amount is
- This is in relation to answer given 1.7 viii. the company has deposited Rs.21 million approximately from sales proceeds of gravel extracts and Rs.200,000 for cash build up account for initial two months after the grace period. The main issue faced by the company was not receiving money from Government Institutions for construction work done to pay the loan.
- Suitable actions need to be taken to prevent this type of situations in the future.
- Rs.289.41 million and it was remaining without recovering. Further the customer had failed to follow the conditions mentioned in the special agreement entered with the bank at the time of granting loan.

<p>iii. The branch had granted 115 Guarantor Loans valued to Rs.121,023,000 for Army officials without verifying repayment capacity of them. Therefore, these loans were turned in to non-performing category and total capital outstanding balance as at 31 December 2020 was Rs.103,082,535 and it was 85 percent of the original loan disbursed. Further satisfactory recovery actions were not taken to recover the outstanding balances from guarantors.</p>	<p>Out of said 115 loans, 07 loans were settled in full by end of 31 October 2021. Balance 108 loans are having Total Capital Outstanding balance of Rs.97,219,083.40 as at 31 October 2021.</p>	<p>Suitable actions need to be taken to prevent this type of situations in the future and Take necessary steps to recover these outstanding balances.</p>
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(ii) Advance on leasing facilities

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
<p>a) The total capital outstanding balance of advances on Leasing as at 31 December 2020 was Rs.1,232,542,955 and non-performing capital balance of advances on Leasing as at that date was Rs.176,847,633 or 14 percent of total capital outstanding balance of advances on Leasing. Further it was observed that 187 leasing facilities which the capital value amounted to Rs.230,969,122 were categorized under watch status which had a risk of subsequently become Non performing status.</p>	<p>Subsequent to several attempts from the branch to get the customers to pay the lease rentals the Lease Termination process was initiated. The Termination notices, Terminations and Seizing orders were</p>	<p>Appropriate actions need to be taken to avoid this type of situations in the future.</p>
<p>b) It was observed that a branch had granted five leasing facilities valued at Rs.12,950,000 during the period 2015 and 2016 without proper evaluation of the</p>	<p>Subsequent to several attempts from the branch to get the customers to pay the lease rentals the Lease Termination process was initiated. The Termination notices, Terminations and Seizing orders were</p>	<p>Appropriate actions need to be taken to avoid this type of situations in the future.</p>

income of the customer and the delay in recovery process, led to fail the seizing attempt and total non-performing balance as at 31 December 2020 was Rs.22,989,757.

issued as below. These customers did not respond to any of these recovery initiatives positively. The Seizers also failed to repossess the vehicle after several attempts.

Thereafter legal action has been initiated subsequent to sending letters of demand

c) A branch had granted a leasing facility amounting to Rs.8,450,000 on 20 October 2017 and subsequently it had been transferred to non performing category on 18 December 2018 due to improper evaluation of the customer income. The outstanding balance as at 31 December 2020 was Rs.11,573,229.

The applicant has been a palmtop customer since 2013 and the first guarantor also had a banking relationship since 2010. After the checking the daily income records of the customer and physical observation of the business income has been considered. Other than the palm top deposits no other documentary evidence has been obtained by the branch. However Bank has strengthened the Branch income evaluation process through trainings to avoid inaccurate income evaluations from happening in the future.

Customers income sauces should to be evaluate properly before granting the leasing facility and steps should be taken to recover the outstanding balance

(iii) Loans and Advances – Employees’ Provident Fund (EPF)

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
Total outstanding value of loans which were granted against the Employee Provident Fund as at 31 December 2020 was Rs.11,085 million and out of that, a sum of Rs.7,334 million had been treated as non- performing loans and it is represented 66.16 percent of the total outstanding. However, it was noticed that non- performing ratio of EPF loans had been increased by 6.86 percent compared with previous year and EPF loans amounting to Rs.176,074,165 was in arrears for more than 540 days as at 31 December 2020.	Due to the Covid-19 pandemic situation the income resources of most of the clients had been affected, anyway we’ll be able to recover the arrears by claim through EPF. When the situation comes back to normal, we’ll follow up recovery with normal recovery procedures.	Take necessary steps to recover these loans

(iv) **Exclusive loan Centre at Hyde Park Corner**

Audit Issue	Management Comment	Recommendation
<p>Exclusive loan Centre at Hyde Park Corner was opened on 02 August 2017 for granting loans over Rs.5 million under Housing Mortgage, EPF and Business Loans category. Following observations are made in this regard.</p> <p>a) 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 million were disbursed up to the date of 31 December 2019 and thereafter services were terminated by this center. The Bank had failed to achieve the expected target of Rs.2,000 million from the aforesaid Loan Centre.</p> <p>b) The bank had re-activated the above Centre on 04 April 2019 renaming as “Credit Marketing Unit by recruiting capable, experienced and trained staff to promote EPF and Business loans for high end customer”, to achieve the 2019 targets and cover arrears of previous year’s targets as much as possible. The targeted loans under the credit marketing unit was Rs.1,500 million during the year 2019. However, the bank had achieved only 1.52 percent (Rs.22.81 million) of the above target. This Credit Marketing Unit was dissolved with effect from 29 November 2019 and remained idle since 02 December 2019. It was realized that the bank was not carried out a feasibility study prior to implementing this center. This premises is presently using as a storage for Hyde Park Corner branch.</p>	<p>The initial objective was not achieved due to lack of customer response. The unit was opened in August 2017 and the services were terminated and officers attached were transferred in mid-2018.</p> <p>Currently valuation officers are using this premises</p>	<p>Proper feasibility study should be carryout prior to take this type of decisions.</p> <p>Suitable strategies need to be taken to prevent un expected targets.</p>

3.4 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
<p>The Bank was categorized under “Other State Owned Enterprises” (SOEs) category by the</p>	<p>We are governed by the HDFC Act No.7 of 1997</p>	<p>Should be adhere the cited direction</p>

Ministry of Finance according to the PED circular No.3/2015 dated 17 June 2015 (Payment of allowances to Chairman, Executive and Non-Executive Directors and Observers). However, the bank has expressed their opinion to audit indicating that as per the 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. Further, the bank has expressed in their reply that the “audit queries based on PED Circulars are not valid, since an Act of Parliament supersedes the directions in circulars”. Further it was observed that the bank had paid travelling allowances without getting the approval from the line ministry and the treasury concurrence for superseding the Public Enterprises Circular No. 1/2015 dated 25 May 2015 and these concerns have been mentioned in last three years audits as well.

and amended 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 as mentioned in previous replies. We are trying to forward the written document in this regard in near future.

3.5 Human Resources Management

Audit Issue -----	Management Comment -----	Recommendation -----
i. 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 the 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
ii. As per the section 9.3.1 of Public Enterprise Department Circular Number PED 12, 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. However, the bank had not complied with the said requirements.	We are governed by the HDFC Act No.7 of 1997 and amended Act No.15 of 2003. Audit queries based on PED Circulars are not valid, since an Act of Parliament supersedes the directions in circulars. We are trying to forward the written document in this regard in near future.	Take necessary steps for the adherence of cited direction