

Housing Development Finance Corporation Bank - 2024

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Housing Development Finance Corporation Bank (“Bank”) for the year ended 31 December 2024 comprising the statement of financial position as at 31 December 2024 and the statement of profit and loss and other comprehensive income, statement of changes in equity, and statement cash flows for the year then ended, and notes to the financial statements, including material accounting policy information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with 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 give a true and fair view of the financial position of the Bank as at 31 December 2024, and of its financial performance and its 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 scepticism 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 Audit Observations on the preparation of Financial Statements

1.5.1 Unreconciled Control Accounts or Record

Audit Issue	Management Comment	Recommendation
<p>i) Although the bank recognizes and records the interest income on accrual basis when preparing the financial statements, penal interest on loans other than EPF loans have been recognized on cash basis.</p> <p>Further, it was observed that the normal monthly interest on loans is calculated by using 360 days per year basis while penal interest calculation is made on 365 days per year basis.</p> <p>In addition, instead of posting daily interest to the GL on lease facilities, the monthly interest is posted to the GL on the installment due date of each month.</p> <p>Accordingly, it was observed that, the bank has used different policies and methods for calculate and recognize the interest income of different loan products.</p>	<p>This is due to system limitation. The Bank will take actions to rectify this issue with the new core banking system. Further penal interest have been recognize base on the probability of recovery is very high.</p>	<p>Adopt a standard methodology for calculating and recognizing interest income across all loan products.</p>
<p>ii) Management had not taken actions to introduce a procedure to identify customer receipts, to settle the loans. Unidentified receipt had been included in the account called “Suspense Receipts Account” and recorded a balance of Rs.2,178,412 as at 31 December 2024.</p>	<p>These are paid by the customers to the third party banks through CDM/CRM machines without references. However, the Bank is continuously taking actions to make the customers awareness.</p>	<p>Need to take actions to introduce a procedure to identify customers’ deposits.</p>

1.5.2 Inappropriate Valuation or Estimation

Audit Issue	Management Comment	Recommendation
<p>i) As per the Impairment policy of the Bank dated 17 December 2024, cash flows are expected to be received at the end of 3rd year from the date of Eviction/Legal cases have been filed for Guarantor loans. Accordingly, the bank has assumed that the guarantor loans on which legal cases have been filed during the year 2024 will be recovered at the end of 2027 and calculated the impairment provision accordingly by forecasting the cash flows at the end of the third year. However, no evidences were available to prove that recoverability of such cash flows at the end of 3rd year to ensure the accuracy of the impairment calculation.</p>	-	Impairment policy should be based on realistic assumptions or estimations.
<p>ii) It was observed that the legal status for some guarantor loans with over 1095 days past due (DPDs) are shown in the system as “Writ cannot be executed”, and therefore the recoverability of these loans are questionable. However, the bank has considered that, these loans will be settled in year 2027 (End of 3rd year from the date of accounts) and has forecasted cash flows accordingly. It was observed that an impairment provision of Rs.1,194,588 has been calculated as at 31 December 2024 by following the above procedure and the provision represents only 39 percent from the total outstanding amount of such loans.</p>	Rectified in 2025	Impairment policy should be based on realistic assumptions or estimations.
<p>iii) Instances were observed that where cash flow forecasted for some loans in the individual impairment calculation in the year 2023 have not been actually received during the years of 2024 and 2025. Details are given below.</p> <p>a) When performing impairment calculation during the year 2023, the Bank has expected a sum of Rs.76,929,500 of cash flows relating to 27 loans to be received in year 2024. However, cash flows relating to 3 loans amounting to Rs.1,651,313 had only</p>	<p>(a),(b),(c) We have improved the process of obtaining OE for ISCs. ISCs are segregated on the basis of customer total exposure. With the customer exposure above Rs.10 Mn such customer is individually assessed with effect from 31/12/2024. Bank issued an addendum</p>	Cash flow estimation should be based on realistic assumptions or estimations.

- been received during the year 2024 which is only 2.15 percent of the forecasted amount.
- b) More than 80 percent of the cash flows forecasted for the year 2024 relating to 37 loans had not been actually received during the year 2024.
- c) When performing the impairment computation for the year 2024, the bank had forecasted cash flows aggregating to Rs.16,983,375 relating to 47 loans as to be recovered in January 2025. However, Rs.2,071,875 or 12 percent had only been recovered during the month of January 2025.
- d) It was observed that only 75 per cent of the claims for EPF loans had been received from the Central Bank for the year 2023 and the balance 25 percent had not been received as of the audited date on 18 February 2025. However, when forecasting cash flows for the EPF Loans, the Bank had forecasted fully claimed amount which is Rs.8.8 million in January 2025 and Rs.27.3 million in April 2025 and seems to be unrealistic
- v) Despite the changes need to be made on base case, best case and worst case scenarios when calculating the Economic Factor Adjustment (EFA) in the impairment computation, the Bank has used the same values as same in previous years.
- Base case scenario – 10%
Best case – 10%
Worst Case – 80%
- to Circular (GCL/2024/295) with formats to record objective evidences and SICR for ISCs in October 2024. From October 2024 objective evidence are collected in this format from branches and the resulting cash flows have been derived based on it. The process will be monitored closely and any short comings will be rectified ongoing basis.
- There is no basis on changing these assumption. As previous economic conditions expectation is still unchanged. However, this will be changed in 2025 considering the economic indicators.
- Economic Factor Adjustment (EFA) should be reassess and revalidate annually.

1.5.3 Going Concern of the Bank

Audit Issue	Management Comment	Recommendation
<p>i) The letter No.02/18/315/ 0150/001 dated 30 August 2024 issued by the Director of Bank Supervision of CBSL to the Chairman of the HDFC Bank has noted the sustainability of the bank is critically challenged due to the following factors,</p> <p>a) Gradual and continued deterioration of the bank and revision of excessive penal interest charged ,</p> <p>b) Fiscal constraints to infuse capital/ challenges faced to raising additional capital,</p> <p>c) Deteriorated asset quality,</p> <p>d) Insufficient guidance and direction from board and board sub committees towards appropriate strategies,</p> <p>e) Lack of competent and skilled KMPs and proper succession planning and effective functioning of bank's operation,</p>	<p>a). The Bank has recorded reasonable fact during 2022/2023. That is Rs.326Mn and Rs.1, 302Mn respectively. Other than these profitable years only 2024 loss of Rs 190.Mn.</p> <p><u>Deterioration of Financial Position</u> Not Agreeable to the concern. In the year 2023, Bank's total Assets grew by 7.7%, adding Rs. 4,852 million. Compared to the Banking Industry growth of 5.0%, HDFC Bank outperformed banking industry during the year 2023.</p> <p><u>Total Assets</u> Year 2022-Rs. 62,881 M Growth (0.1%) Year 2023-Rs. 67,733 M Growth 8.0%</p> <p><u>Overcharged Overdue Income</u> As per the CBSL guidelines, the bank is authorized to charge a penal interest rate (at present 2% p.a) over and above. The agreed rate on the overdue capital and interest. However, the bank has used an average overdue interest rate on the overdue portion of the loan. The overdue interest rate therefore had been either higher or lower than the CBSL stipulation and the resultant over charged and under charged amounts from 01/01/2017 up to 31/08/2024 is appended below;</p>	<p>Bank should ensure full compliance with CBSL directives and need to implement remedial actions for the factors highlighted by the Central Bank of Sri Lanka.</p>

Overdue Interest – Under/Over Charged

Overcharged Rs. 325.3 M

Undercharged (Rs. 166.4 M)

Net Difference Rs. 129.6 M

Net Overcharged Overdue interest as a percentage of the total Profit after Tax from 2017 -2024 was just 3.0% only.

Therefore we are not agreeable (a)

Year	Capital Amount(Rs M)	Minimum CAR %	Actual Ratio %
2023	8,253.23	12.50	37.34
2024	7,416.60	12.50	33.97
2025 (up to 30.06.2025)	7,592.00	12.50	30.67

b)The Bank’s capital remains well above the minimum capital requirement prescribed by the CBSL.

c) The Bank’s loan portfolio remains well secured. The Bank is capable of recovering Non-Performing Loans (NPLs) through necessary legal and recovery actions. During the past 12 months, the loan book has not grown due to CBSL restrictions. As a result, the NPL ratio has increased because the denominator of the ratio has been continuously declining, which gives a misleading interpretation of the Bank’s asset quality. Furthermore, the outstanding EPF claim balance is expected to be received in November 2025, which will further improve the Bank’s asset quality.

d) The Board and its Sub-Committees meet in accordance with their respective Terms of Reference (TORs) and provide adequate direction and guidance to ensure appropriate strategies are implemented. The Board and Sub-

	<p>Committees comprise professionally qualified and competent Directors with expertise in banking and related fields.</p> <p>e) The Key Management Personnel (KMP) team possesses the necessary qualifications, experience, and capabilities to ensure strong governance, regulatory compliance, and sound decision-making at all levels. All KMP positions have been filled with competent and professionally qualified officers with banking experience to further strengthen the corporate management structure. The Bank's strategy is to groom successors internally while also recruiting externally when necessary.</p>	
<p>ii) As per the same letter mentioned in above</p> <p>(a), Governing Body has instructed the Bank to restrict the followings, ,</p> <p>a) From granting mortgages including EPF loans and increasing of deposits beyond the existing level.</p> <p>(b) Relocating branches, increasing management allowances, incurring non-urgent and non-essential expenditure, purchasing any movable and immovable properties, entering in to any new contract with any party, recruiting new staff and withholding expenditure or provisions made with respect of bonus or ex gratia payments.</p>	<p>ii)</p> <p>a) The restrictions on EPF loans have been lifted, and new loans will be granted upon obtaining approval from the Department of Labour, which is expected in November 2025.</p> <p>b) The Bank has fully complied with the CBSL restrictions imposed by the letter dated 30.08.2024 issued by the Director of Bank Supervision.</p>	

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
<p>(i) Intersystem Control Account</p> <p>The control account between two systems namely Core Banking System (CBS) and Loan Management System (LMS) called “Intersystem Control Account” under other assets included an unreconciled amount of Rs.12,866,471 and reconciliation had not been presented.</p>	<p>These are due to two different systems running two different times. This issue can be resolve with the new core banking system implementation.</p>	<p>Need to Perform a complete reconciliation of the intersystem control accounts and identify the exact source of discrepancy.</p>

1.6.2 Payables

Audit Issue	Management Comment	Recommendation
<p>(i) Unclaimed Deposits</p> <p>An excess amount of Rs.1,538,713 payable to customers after auctioning of pawning articles are included in the unclaimed deposit account as at 31 December 2024 without transferring to customer’s savings account or paying to customers since more than 3 years period.</p>	<p>The Bank has several times tried to contact the customers but did not responded and therefore these items were transferred to unclaimed account.</p>	<p>Need to take actions to pay the unclaimed deposit balances to the relevant customers.</p>
<p>(ii) Dividend Not Presented</p> <p>Action had not been taken to settle a sum of Rs.4,422,075 accumulated as dividend not collected by shareholders during the period from 2009 to 2022.</p>	<p>These dividend are paid but not yet presented.</p>	<p>Need to take actions to pay uncollected dividends to shareholders.</p>
<p>(iii) Penal Interest Overcharged Payable Balance</p> <p>Penal interest overcharged amount of Rs.12,057,902 from EPF back loan customers by the bank had not been repaid to customers due to fully settlement of loan balances. Bank has not taken reasonable actions to pay this balance to customers.</p>	<p>Part of this has been already settled to the customers. Balance are processing to settle. However the customers are not responding to the letters given.</p>	<p>Need to take actions to pay the remaining overcharged penal interest balance to customers.</p>

1.6.3 Advances

Audit Issue	Management Comment	Recommendation																																
i) Loan and Advances																																		
<p>a) The gross total outstanding balance of loans and advances as at 31 December 2024 was Rs.43,226 million and the corresponding balance in the preceding year was Rs.43,621 million. As well the balance of Stage 3 loans, as at end of the year 2024 was Rs.21,029 million and this shows an increase of Rs.2,081 million compared to the Stage 3 loan balance of Rs.18,948 million in the preceding year. Furthermore, an amount of Rs.2,595 million was allocated as impairment provisions for Stage 3 loans as at 31 December 2024, which shows an increase of 26.7 percent when compared to Rs.2,047.5 million allocated in the preceding year.</p>	<p>a),(b) and (c) Root cause analysis on deterioration on credit quality developed and a time bound action plan submitted to the BIRMC. Several training programs have been held to relevant staff on providing quality credit. A Board approved Baseline credit & collateral standard developed to improve new credit granting. Further amendments to the credit granting criteria to improve credit quality Granting EPF loans to non-contributing members done to reduce dependency on EPF loans and improve credit quality Corporate and SME loan approving functions have been centralized.</p>	<ul style="list-style-type: none"> • Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank. • Implement stricter monitoring and follow-up mechanisms to minimize future defaults. • Accelerate recovery efforts of the Bank. 																																
<p>b) As per the Loan Management System (LMS) of the bank, Bank has granted loans under six product categories. The total outstanding balances and 90 days past due balance under each product category as at 31 December 2024 are given below.</p>	<p>There is a significant improvement in quality of loans granted after 2020 due to improvement in credit criteria/processes, with excluding EPF NPL recording less than 7% for loans granted after 2020. (56% of the excluding EPF loan portfolio consists of loans granted after 2020). Annexure 7/CR.</p>																																	
<table border="1"> <thead> <tr> <th data-bbox="203 1335 285 1444">Loan product Category</th> <th data-bbox="358 1335 477 1528">90 days past due status as at 31.12.2024) Rs.mn</th> <th data-bbox="505 1335 651 1528">Total outstanding (Capital Interest arrears+Other charges)</th> <th data-bbox="695 1335 748 1444">NPL Ratio %</th> </tr> </thead> <tbody> <tr> <td data-bbox="203 1545 250 1566">EPF</td> <td data-bbox="407 1545 477 1566">16,381</td> <td data-bbox="597 1545 667 1566">21,852</td> <td data-bbox="732 1545 764 1566">75</td> </tr> <tr> <td data-bbox="203 1587 305 1608">Guarantor</td> <td data-bbox="423 1587 477 1608">2,419</td> <td data-bbox="613 1587 667 1608">6,023</td> <td data-bbox="732 1587 764 1608">40</td> </tr> <tr> <td data-bbox="203 1629 302 1650">Mortgage</td> <td data-bbox="423 1629 477 1650">4,646</td> <td data-bbox="597 1629 667 1650">13,379</td> <td data-bbox="732 1629 764 1650">35</td> </tr> <tr> <td data-bbox="203 1671 285 1692">Leasing</td> <td data-bbox="440 1671 477 1692">106</td> <td data-bbox="630 1671 667 1692">604</td> <td data-bbox="732 1671 764 1692">18</td> </tr> <tr> <td data-bbox="203 1713 305 1734">Cash back</td> <td data-bbox="440 1713 477 1734">17</td> <td data-bbox="613 1713 667 1734">2,679</td> <td data-bbox="732 1713 764 1734">1</td> </tr> <tr> <td data-bbox="203 1755 250 1776">Gold</td> <td data-bbox="440 1755 477 1776">11</td> <td data-bbox="613 1755 667 1776">1,362</td> <td data-bbox="732 1755 764 1776">1</td> </tr> <tr> <td></td> <td data-bbox="407 1797 477 1818">23,582</td> <td data-bbox="597 1797 667 1818">45,899</td> <td></td> </tr> </tbody> </table>	Loan product Category	90 days past due status as at 31.12.2024) Rs.mn	Total outstanding (Capital Interest arrears+Other charges)	NPL Ratio %	EPF	16,381	21,852	75	Guarantor	2,419	6,023	40	Mortgage	4,646	13,379	35	Leasing	106	604	18	Cash back	17	2,679	1	Gold	11	1,362	1		23,582	45,899		<p>Further following recovery related actions taken. 1. Initiated legal actions for long overdue clients. Bank has filed 696 court cases against long overdue customers.</p>	
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- c) The following table depicts the ratio of stage 3 loans to total gross loans and advances and total impairment coverage ratio of the bank during last 5 years period. Accordingly, it was observed that, the Bank's stage 3 loan ratio had been increased during last five years period.

years	2024	2023	2022
Percentage of Stage 3 loans to gross loan and advances (%) *	45.92	40.92	37.97
Total impairment Coverage ratio *	9.91	9.07	8.81

* Including Undrawn Portion of Credit

- d) As per the Loan Management System (LMS) the bank has granted 16754 number of loans amounting to Rs.8,718,177,274 during the year 2024. Out of those loans, 1757 number of loans had been classified as 90 days past due status during the year under review and the granted amount and total outstanding amount recorded as Rs.1,346,820,199 and Rs.1,457,209,600 respectively as at end of year 2024.

ii) Top 10 Non Performing Loans

As at 31 December 2024, 31 percent of the Bank's total loan portfolio consists of mortgage loans. According to the Bank's Loan Management System, the top 10 non-performing loans (NPLs) (more than 90 days past due status) are all from mortgage loan category.

It was observed that out of the total outstanding balance of these top 10 NPLs, a significant exposure of Rs.795.9 million relates to two companies within the same group (Daya Group (Pvt) Ltd). The details are given below.

2. More focus on collecting current dues as a result collections have increased year on year basis by 265Mn (2023 Vs 2024). NPL capital has reduced by Rs 202 Mn year on year basis. (2023 Vs 2024)

3. Specific attention provided to collect EPF overdue to safeguard the interest of the borrower. The EPF loan collection has increased by Rs 559 Mn year on year basis. (2023 Vs 2024) However, it has been observed that despite strengthening the credit process of EPF backed loans the NPL reduction in EPF backed loans is very much low. This is mainly due to purposeful default by the borrower.

This is due to business model in the bank. ECL is the model derived provision as per the business model, the bank operates.

Customer	Granted amount Rs.mn	Total Outstanding Rs.mn
1 Olympus Constructions (Pvt) Ltd	250	337.8
2 Bimpuh Finance PLC -1	350	397.3
-2	42	60.8
3 State Development and constructions Corporation	84	34.7
4 SEC on account of NEMO	62	87.1
5 R K Muhandirumge Shamil Randika	50	111.2
6 Madampe Mills Pvt limited	49.9	51.1
7 Kadupithi Nuwan Sanjaya 1	30	61.9
... 2	12.5	12.2
8 Nomic International Ltd	25	32.7
9 Dinesh Sampath 1	24.5	34.3
2	10.1	12.2
1 Sethma Trading Lanka (Pvt) LTD	20	40.4

iii) Audit observations related to non-performing loans and advances of the Bank including top 10 non-performing loans are given below.

a) Olympus Constructions (Pvt) Ltd

This is a private limited liability company incorporated in January 2014 and engaged in highway and building constructions, heavy steel fabrications and electrical installation, bridge a water supply drainage, storm water drainage etc. This is a subsidiary company of Daya group (Pvt) Ltd.

A credit facility of Rs.350 Million has been requested by the above company by mortgaging a land as a security for working capital requirement. This loan had been approved at a Special Board Meeting held on 07 June 2019 (board paper no. 01/SPL/06/2019). At the said meeting, Board noted that “Internal Valuation Report is pending as the internal valuation officer reported that he

HDFC Bank filed this case against two Directors. **Case No. CHC 14/22MR-** Ex parte Judgement against 1st & 2nd defendants on 04/11/2025.

Subsequently Bank has advertised to sell the property in newspapers in December 2023, June 2024, November 2024 & March 2025. But no offers received for this property. Bank continue to see the possibility of selling this property.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank by enhancing customer due diligence and creditworthiness assessments
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.

cannot quantify the soil for the valuation". However, loan had been approved by considering the valuation of the mortgaged land given as Rs.1 billion including estimated soil income of Rs.993 million given by a Private valuation officer. Subsequently, it was observed that internal valuation officer had submitted his report on 07 June 2019 for Rs.72 million (FSV) without incorporating the soil income and he recommended for not to incorporate intangible asset value when valuing mortgaged assets since at the beginning.

Accordingly, the Bank had granted Rs.100 million and Rs.150 million worth of 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 just after six months from the granting. Further, the customer had failed to comply with the conditions mentioned in the special agreement entered with the bank at the time of granting the loan.

Subsequently Board resolution had been passed on 30 November 2020 to execute parate powers and mortgaged property was acquired by the bank at the public auction held on 24 March 2021.

Further, the Bank had advertised to sell the land in newspapers twice (22 June 2021 and 18 November 2022) and only one offer received for Rs.44 Million. However, the tender committee refused to sell the property.

As per the Loan system of the bank, total outstanding balance as at 31 December 2024 was Rs. 337,817,367. (Including total capital with capital arrears Rs.249,717,321, interest arrears Rs.51,893,845, OD arrears of Rs. 33,732,161 and charges of Rs.2,474,039). Finally, the Bank had taken

- Accelerate the recovery efforts of the Bank

Legal action and Letter of Demand had been sent to the borrowing company and two Directors on 15 December 2023.

b) Bimpuh Finance PLC

Bimpuh Finance PLC, incorporated as a Quoted Public Limited Liability Company on 27 July 2007 and engaged in the business of micro finance activities. This is a subsidiary company of Daya Group (Pvt) Ltd.

The board of directors at its meeting held on 9 May 2018 had approved a loan amount of Rs.350 million to Bimpuh Finance PLC without considering the disagreements of three directors. Loan had been disbursed in 2018 for working capital requirements of Bimpuh Finance PLC by accepting mortgage bond over active loan portfolio of Rs.525 Million and corporate guarantee of Daya Group (Pvt) Ltd (Parent company) as securities. Loan had been rescheduled twice during the year 2020 via board approvals. This loan was transferred to non-performing category on 29 June 2022.

The Bank had granted another loan amount of Rs.42,038,971 on 19 November 2021 for the period of 2 years and it was transferred to non performing category on 28 October 2022.

Subsequently, the Fitch rating of Bimpuh Finance PLC was downgraded from “BB (lka)” to “CC (lka)” after mainly considering factors such as weak capitalization, liquidity risk and severe deterioration in its asset quality and License of the company had been canceled on 01 September 2023 by the Central bank of Sri Lanka.

Total outstanding balance of the first loan as at 31 December 2024 was Rs. 397,350,561 (Including total capital with

Actions Taken including dates

i. CHC 41/24 Co (Winding Up Case)- Case filed by HDFC Bank to windup Bimpuh Finance PLC.. Written Submission on 07/11/2025- Winding up order has been granted in HDFC favor.

Then the respondent filed an Appeal to Supreme court.

ii. SC/HCLA/12/25 (Supreme court Appeal Case)- 10/11/2025- To Support.

iii. CHC (Civil)-17/25Co (Personal Guarantor Case) HDFC Bank filed another case for guarantors. Matter is coming up for Pre Trial on 28/01/2026 However in the mean while

Director Dayagamage also met the management on 04/09/2025 and proposed a settlement plan. Same was presented to the board and management convinced the board that settlement plan proposed was not acceptable. Subsequently Mr Dayagamage inquired the board recommendation about his new proposal. Management informed him that a discussion would be arranged to see the possibility of getting an acceptable settlement plan.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

capital arrears Rs.246,899,661, interest arrears Rs.70,695,995, OD arrears of Rs.75,754,539 and other charges Rs.4,000,365) and total outstanding balance of the second loan was Rs.60,821,667 (Including total capital with capital arrears Rs.42,038,971, interest arrears Rs.5,832,980, OD arrears of Rs. 12,949,666 and other charges Rs.50) .

The Bank had taken legal actions against the parent company, Daya Group (Pvt) Ltd. Another case has been filed for liquidation of the company and liquidation order has been issued on 14 February 2025. Bimputh Finance PLC had filed a case in appeal court against the liquidation order.

c) State Development and Construction Corporation

State Development and Construction Corporation (SD &CC) was incorporated in 1 October 1971 as an engineering institution under State Industrial Corporation Act No. 49 of 1957 and is currently under the purview of the Ministry of Housing and Construction. The corporation engages with activities of developing infrastructure facilities of the country and planning, designing and constructing bridges.

The bank has planned to grant a loan facility amounting to Rs.200 million for the purpose of financing working capital requirement relating to construction of 23 bridges under “Nagamu Purawara Project” in Hambanthota District and the decision was approved at the credit committee meeting held on 26 March 2019. However, as per the risk manager’s perspective, he did not recommend to grant this loan

Parate actions were on hold due to government restriction up to September 2025. However SD&CC informed us that there is a cabinet approval obtained to sell another property of SD&CC and settle HDFC & Peoples bank loans. And they requested 6 month time to selling process.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthened.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

facility since being categorized under high risk category as per the risk analysis report. Although, the Board of Directors' approval has been granted for this loan on 28 March 2019 by imposing several conditions.

Subsequently, the credit committee considered the revised loan amount of Rs.85 million due to 60 percent limit imposed on collateral value and additional security given through tripartite agreement with National Housing Development Authority (NHDA) at the credit committee meeting held on 8 May 2019. However, risk manager has left from the recommendation of granting the Loan, due to substantial risk due to categorize under under BB grade.

Further, credit facility has been approved by Related Party Transaction Monitoring Committee on 13 May 2019 and finally, the board has approved the loan facility of Rs.85 million at their meeting held on 16 May 2019. Total loan amount had been disbursed in 5 occasions within short period of time from 6 June 2019 to 4 July 2019.

On request of the corporation, approval had been granted to reschedule this loan for another 3 months by the board at their meeting held on 21 October 2019. As per the minute of the board meeting held on 14 October 2020, it had been agreed to extend the balance repayment period upto 5 years with 6 months' grace period commencing from November 2020 and reduce future interest rate to AWPLR plus 2 percent review on quarterly basis.

It was agreed at the board meeting held on 28 October 2020 to reschedule this loan facility amounting to Rs.55,849,331 with effect from May 2021 for further 5 years period. In addition to that, due to prevailing economic and social issues, the bank and

SD & CC has agreed on a repayment plan of Rs.200,000 per months for 12 months' period. Subsequently, by considering the request of SD & CC, during the Covid 19 period and in compliance with the CBSL circular instructions, the bank had granted moratorium loan facility of Rs.7,548,655 on 02 August 2022 to the Corporation.

The Loan had been transferred to non-performing category on 29 June 2022. Due to non-payment of the loan, the bank has decided to execute parate action on mortgaged land on 7 February 2023. Further, the mortgaged property has been valued at Rs.170 million and forced sale value was Rs.160 million as at 19 April 2023.

Total outstanding balance of the loan as at 31 December 2024 amounting to Rs.34,728,950 (total capital with capital arrears Rs.29,973,392, interest arrears Rs.3,301,148, OD arrears of Rs.1,444,410 and charges Rs.10,000) was remaining without recovery.

d) State Engineering Corporation (SEC) on account of National Equipment and Machinery Organization (NEMO)

National Equipment and Machinery Organization is a construction organization established under State Engineering Corporation of Sri Lanka. The bank has approved a revolving credit facility of Rs.150 Million for the State Engineering Corporation (SEC) on behalf of National Equipment and Machinery Organization (NEMO) on 17 October 2018.

As per the loan disbursement's conditions, loan can be granted based on bills receivable from NEMO to National Youth Corps projects from Department of Building.

Accordingly, it was observed that on 9 October 2018, 1st loan of Rs.51 million has

Case No. CHC 08/21MR-

Legal proceedings are ongoing, and the judgment is scheduled to be delivered on 03.12.2025. The entity is a government-owned organization.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthen.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the

been disbursed based on uncertified bill value of Rs.86 million, 2nd loan of Rs. 11.157 million was disbursed on 13 February 2019 on uncertified bill value of Rs.18.59 million. In addition, 3rd loan of Rs.9.238 million was disbursed on 17 April 2019 on uncertified bill value of Rs.15.39 million. Accordingly, total amount of credit facility of Rs.71.395 million had been disbursed on uncertified bills except certified bills.

The security documents taken for the loan were (i) Loan agreement for Rs.150 million, (ii) irrevocable letter of undertaking which shall submitted by national youth corporation and (iii) promissory notes submitted by SEC to the value released by bank on uncertified bills repayable in six months or on demand.

According to the agreement, this Loan is repayable by the SEC to the bank within 1 year from the date of first disbursement or on demand by the bank. However, SEC failed to repay the loan and subsequently, it was transferred to non-performing category on 16 July 2019.

Total outstanding balance of the loan as at 31 December 2024 was amounting to Rs.87,112,599 (Including total capital with capital arrears Rs.39,253,323, interest arrears Rs.1,391,154, OD arrears of Rs. 45,161,147 and charges Rs. 1,306,975) and legal case against SEC had been filed in Commercial High Court on 07 January 2021.

recovery efforts of the Bank

e) R.K.M.S.R. Ranaweera

The above person has taken a loan to purchase a commercial property. The Bank had granted a business loan of Rs.50 million to the said customer on 28 February 2018, against mortgage over a property. At the time of loan disbursement, bank had failed to

01) Case No.

CHC/140/21/MR
Borrower filed this case at Commercial High court to get an interim injunction against HDFC Bank.

Order given in favor of HDFC

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the

consider other three loan installments aggregating to Rs.323,488 which are in arrears as per the CRIB report when assessing the customer's repayment ability. It was observed that the disposable income of the customer after deducting above installments, was Rs. 982,509, which is lower than the equal monthly installment (EMI) of Rs.1,256,110 of the respective loan. Subsequently, due to difficulty of recovery, the loan had been transferred to the non performing category on 24 March 2019.

Bank has taken steps to sell the mortgaged property through parate execution obtained by way of board resolution passed on 29 April 2019. Further, the bank had gazetted a notice of sale of property on 27 September 2019. However, customer had filed a case to get an enjoining order against the bank by preventing the Bank from parate execution. The final order has been granted in favor of the bank and then customer appealed in the Supreme Court. In addition, initial seller of the above property had filed a case in Marawila District Court and call for Summons returnable as at 19 September 2025.

The total outstanding balance of the loan as at 31 December 2024, was Rs.111,218,536 (Including total capital with capital arrears Rs.43,881,550, interest arrears Rs.17,787,502, OD arrears of Rs.47,918,686, and charges Rs.1,630,797). As per the valuation report dated 16 June 2023, forced sale value of the property was Rs.79 million (Market value was Rs.98 million) which represents 71 percent of the loan value.

Bank and borrower filed an appeal to the supreme court. CHC 140/21MR matter is coming up for Trial on 03/11/2025.

02.) SC/HC/LA/107/2022
Supreme court Appeal Case)
Granting leave refused.10/03/2025

03.) DC Case No 3724
Previous Land owner (Seller) filed a case in Marawila. Case will be called on -11/12/2025 for summons returnable.

Bank.

- Risk assessment process before granting loan should be strengthen.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

f) Madampe Mills (Pvt) Limited

The bank 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. Further, the loan repayment period had been extended up to 7 ½ years inclusive of the grace period. The Company had failed to achieve their projected manufacturing targets as per their project proposal. After obtaining the loan, the company had recorded a loss of Rs.109.4 million and Rs.12.9 million in the years of 2020 and 2021 respectively. Following observations are made in this regard,

- Contrary to the Section 4.2.11 in the Credit Operations Manual, the bank had granted 78.13 percent of forced sale value of the mortgage property as a loan and in addition to the land mortgage, two directors of the company had pledged as personal guarantors for the aforesaid credit facility.
- Contrary to Section 3.4.5 (a) of the Credit Operation Manual, the bank had obtained third party property as the security. As evidenced, the mortgage property was owned by the Managing Director's wife, who was not a director of the company. The bank had still failed to vest the mortgage land.

The total outstanding balance of the loan as at 31 December 2024 was Rs. 51,168,397. (Including total capital with capital arrears Rs.31,726,664, interest arrears Rs.7,785,177, OD arrears of Rs. 10,712,750, and charges Rs.943,806)

g) K.N.S. De Silva

The bank had granted two loans aggregating to Rs.42.5 million to this

Madampe Mills, U.Damayanthi Liyanage and Palwatte Coconut Industries (PVT)Ltd filed this action to get an Interim Injunction against HDFC Bank. Settlement entered on 16/02/2024. Consent Decree filed.

Customer paid Rs 40Mn in February 2024 to halt an auction but failed to pay the remaining balance till now. Since government restrictions on parate execution now removed bank is in the process of auctioning the property.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthen.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

01). Case No. DSP/236/23- Borrower filed a case to get an

- Take necessary actions to grant loans and advances to

customer for Business purpose on mortgaged over property. First loan of Rs.12.5 million had been granted on 30 December 2016 for 10 years period. Second loan amounting to Rs.30 million had been granted on 06 September 2018 for 11 years period. These two loans have been categorized under Non-performing category since 17 February 2020 and 29 January 2021 respectively and the Bank had send letter of demand on 05 April 2022 to initiate legal actions.

Even though, the Bank had taken actions for auction the property in public, borrower had filed a case (case no: DSP236/2023) against the auction of pledged property. The court ordered to stop the auction for the period from 14 June 2023 to 28 June 2023. Subsequently, court has ordered to cancel the request of injuncting restraining order on 23 October 2023 against the bank. Hence, the bank auctioned the property in public on 27 November 2023 and property has been vested to the bank due to unavailability of qualified buyers in the auction. The customer make a petition in the appeal court against the Injunction order and finally, the case had been finalized and customer has agreed to pay the loan amount as partially. However, by violating the condition of appeal court, customer had failed to repay the loan.

Total outstanding balance of the first loan (Rs.12.5 million loan) as at 31 December 2024 was Rs.12,214,367. (Including total capital with capital arrears Rs.8,386,504, interest arrears Rs. 1,848,699, OD arrears of Rs. 1,190,420, and charges Rs.788,744)

interim injunction against HDFC Bank for prevent auction and the property now vested with the bank as interim order vacated and fixed for Pre Trial on 21/10/2025.

02.)WP/HCCA/COL/177/23LA
(Civil Appeal Matter)-Settlement entered.

03.) 8745/L

(Negambo Dc case-filed by Nuwan Sanjaya's father) Answer of 1st defendant, 2nd defendant- Answer filed, 3D- Exparte Trial on 12/01/2026.

04.) B 5971

Negambo Magistrate Court case- HDFC Bank filed a police complaint to get the possession Matter is coming up for Investigation on 26/01/2026.

eligible customers in accordance with established circulars and guidelines of the Bank.

- Risk assessment process before granting loan should be strengthened.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

The total loan outstanding balance of the second loan (Rs.30 million loan) as at 31 December 2024 was Rs. 61,962,498. (Including total capital with capital arrears Rs.31,473,064, interest arrears Rs.21,766,381, OD arrears of Rs. 8,338,724, and charges Rs.384,328) and days past due (DPD) was 1493 days.

Following deficiencies were observed within the granting process of the above two loans,

- As per the Section 4.1.9 of the Circular numbered GCL/2019/259 dated 09 January 2019, if the mortgage property is used for business purposes, the loan amount should be limited to 70 percent of the Forced Sale value of the mortgaged property. However, as per the valuation report, when granting the first loan of Rs.12.5 million, forced sale value of the property was Rs.15 million and the granted amount represents 83 percent of the forced sale value of the mortgaged property.
- As per the Section 9.3 of Manual on Credit Operation, when a property is mortgaged for a purpose other than the purchase of a land, fire insurance must be obtained and the fire insurance policy should be renewed until the end of loan maturity period, 30 September 2029. However, it was observed that, fire insurance policy had not been renewed.

h) Nomic International Ltd

Nomic International Ltd is a company incorporated in 2014 and engaging in microfinance business. This Company has not registered under the Central Bank of Sri Lanka (CBSL) as per the

Five loans have been fully settled.

- Settlement agreements have been entered into for six loans, and the customers are servicing them regularly.
- One customer is currently residing abroad; therefore, legal

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.

Microfinance Act and not monitored by the CBSL.

The said Company has requested a loan facility of Rs.50 million for the purpose of Portfolio Growth and redemption of an existing loan. Under the approval of credit committee meeting held on 27 January 2022, the bank has approved to disburse only Rs.25 million without obtaining new loan requisition form from the customer for Rs.25 million. It was observed that, loss of the company for the 9 months ended 31 January 2020 was Rs.4.2 million.

The risk division has not recommended to grant this loan due to having very unhealthy level of leverage position of the Company which would hinder the loan repayment capacity in a slight stress condition. As well in a difficult situation, it is not possible to utilize the loan security for immediate recovery of loan commitments and bank has no control over the loan portfolio. This facility has been graded under “BB” speculative facility quality. However, without considering these risk concerns, and without obtaining approval from next higher level of authority, the credit committee had approved to grant Rs.25 million worth of credit facility to the said company and the loan has been granted on 17 February 2022. Bank has obtained performing microfinance Loan Portfolio not less than Rs.37.5 million and two directors’ personal guarantees as securities for this loan.

The Company had failed to comply with the special conditions mentioned in the loan agreement, such as (i) at the end of the each financial year, audited Financial Statements certified by two Directors of the company had not been provided for bank review and, (ii) List of performing

action cannot be initiated. However, this customer continues to remit instalments from overseas.

- Legal proceedings are in progress for 12 facilities.
- Legal action is yet to be filed for one facility.

- Risk assessment process before granting loan should be strengthen.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

loans had not been updated & certified by the directors on half-yearly basis and it had not been submitted to the bank

Subsequently, the loan was transferred to non-performing category on 09 March 2023. According to the business visit dated 20 June 2023, it was revealed that Nomic International has stop their lending and involving only with recovery activities. Most of loans are in NPL category and monthly collection was around only Rs.350,000. However, it was observed that they have to pay considerable amount of loan installments for loans obtained from other banks as well.

As at 31 December 2024, the total outstanding balance of the above loan was Rs. 32,700,935 (Including OD arrears of Rs.5,235,063 and other charges of Rs.80,300).

i) D.S. Wanigasekara

The bank had granted Rs. 24,500,000 to the above customer at the rate of 15.94 percent on 06 May 2019 and Rs.10,170,584 at the rate of 6.93 percent on 25 November 2021 to improve the business and to purchase a Hotel respectively.

Land with an extent of 20 perches situated at Dambulla area in Mathale Districk had been taken as a security. Subsequently first loan and second loan had been transferred to non-performing category on 22 November 2022 and 30 October 2022 respectively.

According to the last valuation conducted on 27 December 2022, this property was valued at Rs.40,200,000.

The bank had auctioned the property on 25 November 2023, and no sales offer has been received for this land, and the Bank acquired the Land at the public auction held on 25 November 2023. At Present Bank is in the process of filing an ejectment case to

Ejectment case filed by HDFC Bank. DSP 248/24 Matter will be called on 21/11/2025 for Order

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthen.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

remove owners from the land.

The total outstanding balances of two loans including capital, interest, OD and other charges as at 31 December 2024 was Rs.46,584,215. The details are given below.

Loan Number	Total C Amo
902728000001	34,360,0
902523000025	12,224,1.

j) S.K.A. Gunawardana

The Bank has granted Rs. 23 million loan to the above customer (Loan No. 302740000002) on 23 March 2022 at a rate of 13.5 percent for a period of 36 months. Subsequently, the loan had been rescheduled by extending period up to 60 months from the date of 16 February 2023. However, the above loan has been categorized under non-performing loans since 27 May 2023.

Due to the non-performing status of the loan, the board had decided to execute the parate powers at the board meeting held on 28 November 2023. After the above board resolution, customer had paid Rs.4,800,000 on 27 December 2023 and the above loan was again categorized under the performing category on 25 April 2024. At the time of granting the loan, following deficiencies were observed.

- Risk officers' recommendation regarding low medium risk quality facility status of this loan had not been considered by the management.
- No documentary evidence was taken to prove the customer's monthly income of Rs.2,908,002. It was obvious that as per the documents available, customer has no any other income to repay the

Our observations revealed that customer has sold part of the property to a third party without bank's consent. Bank is the process of taking legal action.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthened.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

loan except selling the land plots.

- As per the initial valuation report dated 01 December 2021, per perch value of the plot of Rs.110,000, had been declined up to Rs.92,000 as per the second valuation report dated 19 August 2023. Therefore, after 21 months, the valuation of the land had declined and the reason was unrevealed. The Bank had failed to obtain the independent valuation report since 22 November 2023 from the Department of Valuation.
- According to the Pradeshiya Sabha letter dated 21 February 2022, the customer has not obtained the local government approval for all the plots after obtaining the loan or purchasing the land.

As at 31 December 2024, total outstanding balance of the loan was Rs.20,171,662 (Including total capital with capital arrears Rs.17,608,570, interest arrears Rs.2,095,712, OD arrears of Rs. 467,079, and charges Rs.300)

k) M/S Sethma Trading Lanka (Pvt) LTD.

Sethma Trading Lanka (Pvt) LTD is an Automobile company and situated in Matara. A sum of Rs.20 million had been granted to the above company on 30 June 2019 at a rate of 17.5 percent for the period of 84 months over mortgaged property. However, this loan has transferred to Non-performing category on 09 March 2023. Even though two public auctions had been scheduled on 30 March 2021 and 27 January 2023, no bids were received, and mortgage property vested to the Bank on 11 April 2023. As per last valuation report dated 12 January 2022, the market value of

Property has been vested in 2023. However, customer filed a case against the bank. Judgement received in favor of the bank and the certificate of sale was received in 2025. Now the bank is in the process of filing Ejectment Case.

- Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.
- Risk assessment process before granting loan should be strengthened.
- Implement stricter monitoring and follow-up mechanisms to

the property was Rs.62.4 million. The total outstanding balance of the loan as at 31 December 2024 was Rs.40,462,996.

The following observations are made in this regard.

- As per the risk assessment report, the above loan was categorized under low medium quality facility due to several concerns . However, the bank had disbursed the above loan without considering such concerns.
 - Though the income evaluation report stated the customer’s monthly income as Rs.1,296,193, no documentary evidence was observed to verify the income.
 - Though the bank had vested this property, no action had been taken to settle the loan up to audited date.

iv) Loan granted for Very Important Professionals (VIP)

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 aggregating to Rs.282,985,000 had been granted under this scheme. Out of the granted 140 numbers of loans, 25 numbers of loans with an aggregated outstanding balance of Rs.47,562,869 as at 31 December 2024 are still to be paid by the customers. Out of this 25 numbers of loans 19 numbers of loans or 76 percent with an aggregated outstanding balance of Rs.32,524,920 had been categorized as Non-Performing category as at 31 December 2024. However, there is no secondary recovery option to the bank due to the unavailability of security.

Three loans have been fully settled. Settlement terms have been agreed upon for five loans, and they are being serviced regularly. Legal actions are being taken for the remaining 19 facilities.

minimize future defaults.

- Accelerate the recovery efforts of the Bank.

• Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank.

- Risk assessment process before granting loan should be strengthened.
- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank.

v) Vested Properties

a) Outstanding balance of loans categorized under Vested Properties (VP) as of 31 December 2024 was Rs.514,552,080. Out of that 86 Vested Properties with an aggregated outstanding amount of Rs.57,060,835 have remained over five years from the date of vested. Details are given below.

Years	Outstanding balance as at 31.12.2024 Rs.	As a Percentage (%) of value of VP
Less than 5 years	457,491,245	8.89
Over 5 – 10 years	38,746,035	7.53
Over 10 – 15 years	9,025,583	1.75
Over 15 – 20 years	5,647,887	1.10
Over 20 years	3,641,330	0.71
Grand Total	514,552,080	100

As of 31st December 2024 bank possessed 100 properties. As at 30.09.2025 this number reduced to 89. Below represents age breakup of the vested properties.

Years	Outstanding balance as at 30.09.2025 Rs.	As a Percentage (%) of value of VP
Less than 5 years	542,145,046.96	89.20
Over 5 – 10 years	35,102,296.12	5.78
Over 10 – 15 years	15,286,828.05	2.52
Over 15 – 20 years	4,405,174.37	0.72
Over 20 years	10,852,914.49	1.79
Grand Total	607,792,259.99	100

- Valuation process and auction process of properties should be strengthen.
- Accelerate the recovery efforts of the Bank.

b) Two loans vested in 1997 and 8 loans vested in 1998 under vested properties were not included in the new LMS system. Details are given below.

Old Loan No	Outstanding as at 13.12.2024 Rs.	Expected realization value Rs.	Vested date
0800000214	79,247.16	500,000	19-Feb-97
400000393	126,688.85	-	31-Dec-97
2200000075	206,933.90	-	21-Mar-98
0500000149	85,507.65	270,000	30-Jun-98
0503300080	67,932.15	300,000	30-Jun-98
0500000156	78,643.65	247,500	30-Jun-98
0503300076	68,605.49	225,000	30-Jun-98
0503300086	69,452.80	300,000	30-Jun-98
2402300010	110,361.00	700,000	30-Jun-98

As per the previous loan system, when a property was vested, the related loan was closed in the system, and the vested properties were separately maintained by the Recovery Division in a manual register.

However, with the implementation of the new Core Banking System in 2017, the practice was revised. Under the new system, when a property is acquired, the loan is not closed; instead, a specific risk code (Code 6) is updated in the system utilizing the new core banking features.

During the data migration process to the new Core Banking System, only active loans from the old system were migrated. Since the acquired property loans had already been closed in the old

- Valuation process and auction process of properties should be strengthen.
- Accelerate the recovery efforts of the Bank.

2300000025 107,872.00 2,000,000 12-Nov-98

system, they were not included in the migration. Consequently, the details of these properties have continued to be maintained manually by the Recovery Division.

Management has reviewed this matter and concluded that, given the system constraints (to capture old loan details such as loan number, tenure, etc.) there is no alternative solution at present other than to continue maintaining these property records manually.

vi) EPF backed Loan

a) It was observed that even a single equal monthly installment (EMI) had not been received for 16 numbers of EPF loans granted during the period from 2016 to 2021. Total capital outstanding balance of those 16 loans was Rs.20,319,950 as at 31 December 2024. Out of them, Rs.16 million or 79 percent had been granted to Rukshan Milroy De Paul in the year 2021.

b) M.De Paul

The Colombo branch of the Bank had granted EPF floating loan facility amounting to Rs.16 million to the above customer (Loan No. 101640000050) on 02 December 2021 and subsequently, it has transferred to non-performing category on 3 April 2022. The outstanding balance as at 31 December 2024 was Rs.11,174,864 (Including total capital with capital arrears Rs.1,600,000, interest arrears Rs.6,085,085, OD arrears of Rs.3,487,979 and, charges Rs.1800) and Days Past Due (DPD) was 1067. Following observations are made in this regards.

a), b) It has been observed that despite strengthening the credit process of EPF backed loans the NPL reduction in EPF backed loans is very much low. This is mainly due to purposeful default by the borrower. Bank is taking every effort to collect the dues. However, it has become very difficult to do recoveries when customer is purposely defaulting despite having repayment capacity. EPF claim of Rs. 5,013,120.72 was received for the year 2023. A claim of Rs. 4,868,075.34 has been requested from the EPF Department for the year 2024. The customer has given his consent to settle the loan in this manner, as he does not have any other source of income to repay it.

• Strengthen loan monitoring and collection processes to ensure timely repayment of EMIs on EPF loans.

- During the period of March 2021 to December 2023, the bank has received only a single payment of Rs.112,970 from this customer.
- The Central Bank had hold this customer's EPF fund for a suspicious reason. Therefore, arrears payment of Rs. 5,522,788 submitted by the Bank as at 31 December 2022 was rejected.
- Customer's salary had not been remitted to the Bank as agreed by the employer.

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

Reference to Laws, Rules Regulations.	Non-compliance	Management Comment	Recommendation
i) CBSL Directions and Circulars			
a) Sec no 03 of Direction no 02/17/600/002/001 dated 26 July 2013, Sec 1.1 and 3.1 of Circular no 2 of 2017 dated 26 May 2017, Sec 2.4 of Circular no 2 of 2019 dated 24 September 2019, Sec 2.3 of Circular no 2 of 2020 dated 21 August 2020, Sec 2.4 of Circular no 1of 2023 dated 25 August 2023	<p>Every LCB and LSB shall reduce the penal interest rates charged on all loans and advances, including credit facilities already granted, to a level not exceeding 200 basis point per annum for the amount in excess of an approved limit or in arrears, during the overdue period. (not exceeding 400 basis point per annum for the period from October 2019 to August 2020).</p> <p>a. However, the bank has charged uniform penal interest rates on all lending products from 2017 to 31 August 2024, irrespective of individual rates and contrary to said CBSL directions. Further, the bank has charged significantly high penal interest rates from 16 percent to 30 percent during the said periods and these rates were applied to loans that had been granted earlier at lower interest rates. As a result, customers were overcharged.</p>	<p>Addressed the concern. This has been corrected and the overcharged amount paid to the respective borrowers.</p>	<p>Bank should adherence to the directions and circulars issued by the Central Bank of Sri Lanka.</p>

b. An amount of Rs.149,813,905 and Rs.58,214,440 pertaining to the excess penal interest charged by the bank during the period from 01 January 2023 to 31 December 2023 and the period from 01 January 2017 to 31 December 2022 respectively, had been adjusted in the financial statements for the year ended 31 December 2024.

- | | | | |
|---|--|--|--|
| b) Section 2.1.ii of CBSL Circular No 02 of 2017 dated 26 May 2017 | Licensed banks shall publish applicable penal rates per annum, if any and the basis of computation, at least in the bank’s website for the information of the public and shall be updated regularly to reflect the current rates. However, penal rates or basis of computation has not been published on website or by using other methods. | Manager Marketing is working with Senior Manager (Branch Network & Banking Operations) & DGM-Credit and Recoveries to finalize the content. Once the content is finalized Manager Marketing will update the website | Bank should adherence to directions and circulars issued by the Central Bank of Sri Lanka. |
| c) Sections 2.2.ii and 2.2.iii of CBSL Circular No 02 of 2017 dated 26 May 2017 | Licensed banks shall inform the borrowing customer of any subsequent changes to the interest rates prior to effecting such revision to the existing credit and applicable penal interest rates, if any, and the basis of computing such rates prior to charging of penal interest at the point of such overdue credit. However, there were no evidences that the borrowers were informed of the aforesaid rates and basis of computations. | Addressed the concern Interest rate increases have been communicated | Bank should adherence to directions and circulars issued by the Central Bank of Sri Lanka. |
| d) No. 16 of 2021 Regulatory Framework on Technology Risk Management and Resilience for Licensed Banks. | Managerial level staff mentioned in the Section 7.3 should comply with the qualification stated in the Section 7.4 of Central Bank Direction. However, it was observed that no staff attached to risk management and internal audit division has the | Progressing The matter has already been communicated to the HR and Compliance divisions. Due to prevailing CBSL restrictions, addressing | Bank should adherence to directions and circulars issued by the Central Bank of Sri Lanka. |

required qualification stated in Section 7.4.1 of the Direction. It will force a risk on prudent management of technological risk of the Bank.

this issue has been delayed, but we are committed to making maximum efforts to complete this task as soon as possible within the current

ii) Banking Act Direction No. 7 of 2011

- | | | | |
|---|--|---|--|
| <p>a) Section B.1.2 (g) of Banking Act Direction No. 7 of 2011</p> | <p>Every obligor and facility must be assigned a risk rating under Credit Risk and Procedures. Currently, the bank assigns a risk rating only to customers with loan facilities of more than Rs.1.5 Million given under mortgage properties and guarantees, as per Circular No. GCL/2019/268 dated 26 August 2019. Assigning a risk rating for all customers and update the system accordingly has not yet been accomplished as per the cited Direction.</p> | <p>Progressing
Assigning risk ratings for every obligor and facility under Credit Risk and Procedures has manually completed. However, the updating of the system is pending due to the current core banking system being declared end-of-life. Meanwhile, a manual workaround process is in place until the new system upgrade is implemented.</p> | <p>Bank should adhere to directions and circulars issued by the Central Bank of Sri Lanka.</p> |
| <p>b).Section D.2.5 of Banking Act Direction No. 7 of 2011 and Central Bank Direction No.04 of 2014</p> | <p>Risk mitigation techniques or tools should be used to contain the severity of operational risk events. Investing in adequate information technology as part of a business continuity and disaster recovery plan is also vital for risk mitigation. Furthermore, as per Central Bank Direction No.04 of 2014, banks should implement the Baseline Security standard for information security management beginning from July 1, 2015. However, the following security controls have not been fulfilled during last 10 years. This situation may create high operational</p> | <p>In Progress
The baseline security standards for information security management controls will be addressed through the implementation of the Information Security Management System aligned with the ISO Information Security Management standards. We continue to monitor the process closely and provide necessary</p> | <p>Bank should adhere to directions and circulars issued by the Central Bank of Sri Lanka.</p> |

risk with in the bank.

recommendations and risk mitigation measures to ensure effective compliance and control.

Name of the Control	Number of Controls	Completed Controls
Information Security Incident Management	5	2
Acquisition, Development and Maintenance of Information Systems	13	6
Operation Security Business Continuity Management	16	10
	5	3

c).Section G 2 Banking Act Direction No. 7 of 2011

There should be stress testing at different frequencies (eg:-weekly, daily) dictated by their respective business requirements, relevance and costs. However, it was observed that the frequency of conducting stress tests seems to be not adequate and an independent assessment on stress testing has not been conducted. This may create risk to the bank since the soundness and effectiveness of stress testing was not evaluated.

In Progress. Stress tests are planned to be conducted at appropriate intervals in line with the approved Stress Testing Program. Ongoing reviews and in-depth analyses of the results are being undertaken to assess potential impacts on the bank's performance. Additionally, modifications are underway to further integrate and enhance the Stress Testing Program.

Bank should adherence to directions and circulars issued by the Central Bank of Sri Lanka.

iii) Compliance requirement of Corporate Governance Directive No 12 of 2007 issued by CBSL.

a). Section 3 (6) ii (1)	Board Audit Committee has had at least two meetings with the external auditors without the executive directors being present. However, only one meeting had been held with external auditor in the absence of GM and other executive management of the bank in 2024.	Partly Complied The Committee has convened only one meeting with the external auditors for the year 2024 in December 2024 upon the finalizing the recruitments of company secretary, General Manager / Chief Executive Officer	Bank should adhere with the requirement of corporate governance directives.
b). Section 3 (6) iv (b)	According to this section, the Board Nomination Committee has considered and recommended (or not recommended) the re-election of current directors. Even though, one director had been re-elected during the year 2024 without having recommendation of Nomination Committee.	Partly Complied as the Board approval is taken. The action to obtain the necessary approvals and compliances were taken. However, due to the submission of the resignation of then Board Secretary and unable to find a date prior to the Board Meeting to convening the Board Nomination and Governance Committee, the fitness & Proprietary affidavit relevant for the re – election of the Director concern was submitted to the Board directly, in order to obtain the Board approval, to submit same to the Central Bank of Sri Lanka for their approval, prior to the Annual General Meeting.	Bank should adhere with the requirement of corporate governance directives.

iv) Loan Recovery Manual

- a).As per Section 4.1.5 of the Loan Recovery Manual of the Bank. In addition to that, as per Sections 6.2,6.3 and 7.1 (a) (ii) in Central Bank Act Direction No.13 of 2020 dated 31 December 2020. The revaluation of Vested Properties should be done at least every 2 years by an internal valuer or at least every 4 years by an external valuer. The Bank should take necessary action to revalue the immovable properties relevant to non-performing loans. However, the bank had failed to revalue properties as per the given instructions. Eight (08) Vested Properties related to loan outstanding balance of Rs.1,266,811 had not been revalued due to failure of clear boundaries. Obtaining Revaluation reports have been failed due to other reasons such these lands being redivided into separate parcels in distinct survey plans which was originally part of a larger tract of land. Secondly due to unclear boundaries/unauthorize d residence and cultivation. Hence this require resurveying these properties. Resurveying the properties is a difficult task in the absence of proper land marks in identifying original state of these properties . Management would see the possibility of resurveying these properties overcoming the stated restrictions. Bank should comply with the requirements stipulated in loan recovery manual.

v) Non-Compliance with Sri Lanka Accounting Standard

- a) Sri Lanka Accounting Standard 16 (LKAS 16) - Property, Plant and Equipment As per section 51 of the LKAS 16, the residual value and the useful life of an asset shall be reviewed at least annually, and if there are any variations should be adjusted in accordance with Sri Lanka Accounting Standard 08, Accounting Policies, Changes in Accounting Estimates and Errors. However, it was observed that the bank had not reviewed the residual value and useful life of its assets for a long period. At present, all fixed asset details and stickers related to the respective assets have been sent to all branches & Head Office. The Administration Division requests each branch & division to nominate one officer to assist in this program. Currently, the fixed Review, Strengthen bank's financial reporting, and internal control system to ensure compliance with SLFRS/LKAS. .

asset valuation process is being carried out across the bank with the support of in-house valuation officers. The entire process is expected to be completed by 31st December 2025.

- | | | | | | |
|----|---|----|--|---|--|
| b) | Sri Lanka Accounting Standards (LKAS-12)- Income Taxes | 12 | As per Section 80 (b) of the LKAS 12, any tax adjustment recognized in the period for the current tax of the prior periods shall be recognized as component of the tax expenses. However, a tax provision difference of Rs.11,743,374 between the financial statements and finalized tax return submitted to the Inland Revenue Department, had not been adjusted as an under/over provision during the year under review. Therefore, the income tax expense and income tax payable balance had been overstated in the financial statements. | This is due to restatement of financial statements with respect to penal interest reversal. The amended return will be submitted in 2025. | Review, Strengthen bank's financial reporting, and internal control system to ensure compliance with SLFRS/LKAS. |
| c) | Sri Lanka Financial Reporting Standard (SLFRS-07) - Financial Instruments : Disclosures | - | As per paragraph 25 of the SLFRS 07, Fair Value of Financial Instruments, except as set out in the paragraph 29, for each class of financial assets should be disclosed in the financial statements. However, the financial assets of Loans and Receivables to Other Customers, Debt and Other Instruments and Due to Depositors (FD), which are categorized at Amortized Cost, have not been properly fair valued and disclosed in the Financial Statements as at 31 December 2024. | These instruments have been proposed valued and presented in the financial statements. | Review, Strengthen bank's financial reporting, and internal control system to ensure compliance with SLFRS/LKAS. |

1.8 Non-compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
<p>i) An aggregated amount of Rs.13,311,541 had been paid as stamp duty by the bank since 2006 up to 3rd quarter 2015 on every deposited amount. Further, the Bank had recognized those amounts as bank's expense in the financial statements during said period. Subsequently, as per the paragraph No. 19 of the Gazette Notification No.1465/20 dated 5 October 2006 which has mentioned that "a receipt given for monies deposited with or withdrawn from, specialized bank licensed by the Monetary Board under Banking Act, No 30 of 1988, are exempted from stamp duty". Accordingly the Bank has taken the following steps;</p> <p>a) The Bank had taken a decision not to pay stamp duty further on deposit with the Bank and withdrawn from the bank since 4th quarter of 2015. Bank has requested an approval from the Commissioner General of Inland Revenue to set off excess paid stamp duty against the future stamp duty payable balance. No reply has been received for the said letter from the Department of Inland Revenue (IRD).</p> <p>b) Further, the Bank had requested an explanation from the Department of Inland Revenue regarding the exemption of stamp duty on receipts of money to the savings account in order to make the respective loan repayment, as per Section 19 of Gazette Notification</p>	<p>This recovery has been adopted as per the income tax consultation operation MS.Amarasekara & Com.</p>	<p>Strengthen internal control over tax compliance of the bank.</p>

- No.1465/20.
- c) Reply letter of IRD, dated 30 November 2016, had mentioned that receipt for repayment of housing loans cannot be considered under above section and it had covered under Section 10 of the Gazette Notification No.1465/19 as discharge given for any money or property. It has further mentioned that, hence the bank is liable to pay stamp duty of Rs.25 on every discharge amount over Rs.25,000.
 - d) Without considering IRD explanation, since 3rd Quarter 2015, the bank had not paid stamp duty on receipt for loan repayments and audit cannot be estimated the unpaid amount due to limited available information of the bank.
 - e) Moreover, up to the end of 4th Quarter 2024, bank had deducted aggregated amount of Rs.7,664,230 from stamp duty liability on Salary, Disbursements and Refinance Loans, against the paid excess amount of Rs.13,311,541 and the deducted amount has been identified as income in the financial statements.

ii) Tax obligation

According to the tax assessment issued on 23 January 2024, undeclared capital recoveries through lease rentals on lease contract entered into on or before 31 March 2018 was Rs.20,935,700. Hence, the Bank had obliged to pay additional tax amount of Rs.52,013,693 for the year of assessment 2020/2021.

Seek future advice from our tax consultant to settle the provision.

Strengthen internal control over tax compliance of the bank.

<p>iii) The VAT on Financial Services and the Social Security Contribution Levy (SSCCL) expenses relevant to restatement made on penal interest in year 2023 had been calculated by the bank without compliance with the related Act. However, differences of the restated amounts between the auditor's calculation and the Bank's calculation were observed. Restated balances of VAT and SSCL calculated by the Bank are higher than those balances calculated by the Auditor by Rs.4,587,662 and Rs.637,175 respectively.</p>	<p>The accounting process is completed and refund process is with the amended return in 2025.</p>	<p>Strengthen internal control over tax compliance of the bank.</p>
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1.9 IT General Controls

Audit Issue	Management Comment	Recommendation
<p>(i) Inadequate IT staff</p> <p>Database administrators (DBAs) play a pivotal role in safeguarding a bank's sensitive information and preventing security breaches. Even though, there is a position for Database Administrator in Bank's approved carder, remains vacant from 21 June 2023.</p> <p>Further, critical job designations such as Information Security Threat Analyst, Manager IS, Manager SOC, SOC Analyst, Executive GRC (One position) Manager DBA, Manager-Digital Banking, Tech Lead in Software Development, Tech Lead in Digital Banking, Software Engineer –IV, Executive Governance Risk & Compliance, Support Engineer positions are also vacant as at 31 December 2024 according to the approved carder.</p> <p>It was observed that this may hinder the effectiveness of the IT operations of the Bank.</p>	<ul style="list-style-type: none"> Recruited Executive Governance Risk and Compliance on 12.06.2024. Two Software Engineers were recruited on 02.05.2024 and 25.03.2024. But both officers have since resigned. Approval has been requested from the CBSL to recruit the minimum required staff for the Bank. Meanwhile, the Database Administrator function has been outsourced. Advertised this position for 06 times. But no one was selected due to high salary expectations and this function currently been outsourced. Thereafter, CBSL restrictions were imposed from 01.09.2024 and we were unable to proceed with the recruitment process. 	<p>Need to recruit vital staff to IT division.</p>

- | | | |
|--|--|--|
| <p>(ii). Significant delays in the user account deactivation process</p> <p>Significant delays were observed in the user account deactivation process on Internet Card Management System (ICMS) and Delinquency Management System (DMS). Upon the observation on samples of deactivated employees, list significant delays were observed due to poor communication between the HR department and IT department of the Bank.</p> | <p>Addressed the concern</p> <p>Now we managed this delay by handling through Email rather than only document.</p> | <p>Need to strengthen user account deactivation process.</p> |
| <p>(iii). Information Security Management System and Business Continuity Management System</p> <p>According to CBSL Banking Act Direction No 16 of 2021, Regulatory framework on technology risk management resilience on licensed banks, the bank shall implement standards issued by International Organization for Standardization (IOS) and obtain mentioned certification or assurance. However, bank had not complied with the Section 8.1.1 and Section 8.1.3 of the Direction requirement, due to not developing Information Security Management System and Business Continuity Management System until 31 December 2024.</p> | <p>Bank has already implemented the Information Security policy in the Bank. Further, bank is ready to go for preliminary audit to validate the assurance for certificate audit. Once that completed Bank will be able to achieve the Certification.</p> | <p>Bank should adherence to directions and circulars issued by the Central Bank of Sri Lanka</p> |
| <p>(iv). Information security policy</p> <p>According to Section 2.2 of Baseline Security Standard, Information Security Policy Document shall be reviewed in planned regular intervals and when significant ICT infrastructure changes occur within the organization. It was observed that the Information Security Policy had not been updated in regular intervals, since its final version is depicted on 1 May 2022.</p> | <p>Addressed the concern.</p> <p>The Information Security Policy is reviewed and received the BOD approval on 26th June 2025.</p> | <p>Need to update Information Security Policy in regular intervals.</p> |

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs.412 million and the corresponding profit in the preceding year amounted to Rs.2,650 million. Therefore, a deterioration amounting to Rs. 2,238 million of the financial result was observed. The main reason for the deterioration is gain on de-recognition of treasury bonds amounting to Rs. 2,661 million in last year which is not a frequent transaction.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review compared with the preceding year with the percentage of increase or decrease are as follows.

Description	Variance Amount Increase/ (Decrease) (Rs. 'million)	Variance %	Reason for the Variance
Net Interest Income	470.4	20.35	Rate decrease of interest expenses is higher than the rate decrease of interest income.
Net Fee and Commission Income	(-22.4)	(6.35)	Decrease of fee and commission income generated from loan related services due to decrease of loan granted by the Bank.
Net Other Operating Income	(2,774.4)	(99.76)	The gain of Rs.2,660 million and Rs.119.5 million earned in the last year on de-recognition of financial investments and from sale of investment property respectively have not been occurred during the year under review.
Impairment Charges	188.84	40.45	Impairment charges had been declined due to result of an improvement of recoveries during the year. Total loan and advance balance had been reduced by Rs.395 million in 2024 compared with previous year.
Total Expenses	(100.2)	(4)	Personal expenses had been increased by Rs.62.3 million due to increase of salary and allowances by collective agreement with effect from 1 January 2024 and other expenses had been increased by Rs.42.9 million due to increase of legal and

professional expenses and computer license fee.

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 compared with the Sector Ratios are given below.

Ratio	Sector Ratio %	2024 %	2023 Restated %
<u>Profitability Ratios</u>			
Net Interest Margin	4.6	4.17	3.5
Return on Average Assets (Percentage)	0.8	(0.29)	1.99
Return on Average Share Holders Fund (Percentage)	12.4	(2.43)	17.70
<u>Capital Adequacy Ratios</u>			
Tier I (Minimum 8.5%)	19.8	33.66	37.02
Tier II (Minimum 12.5%)	22.9	34.65	39.03
<u>Assets Quality Ratio</u>			
Stage 3 Loans to Total Loan Ratio	12.9	45.92	40.92
Total Impairment Coverage Ratio	6.1	9.91	9.07
<u>Liquidity Ratio</u>			
Liquidity Coverage Ratio	343.4	223	394

- (i) Return on Average Assets (ROA) and Return on Average Share Holders Fund (ROE) had been decreased by 2.28 percent and 20.13 percent respectively in the year under review compared with the previous year. Reasons for the above deterioration were the unavailability of last year gains of Rs.2,660 million earned on de-recognition of financial investments and Rs.119.5 million earned from sale of investment property.
- (ii) Stage 3 loans to total loans and advance ratio had been increased from 40 percent to 45 percent due to increase in stage 3 loans by Rs.2,081 million compared with the previous year.
- (iii) The Liquidity Coverage Ratio had decreased from 394.4 percent in 2023 to 223 percent in 2024 and it was below the industry average of 343.4 percent.

(iv) Tier I and Tier II Capital Adequacy Ratios of the Bank had decreased by 3.36 percent and 4.38 percent as at 31 December 2024 respectively. Those are higher than the minimum statutory requirement of 8.5 and 12.5 percent respectively.

(v) Net interest margin of the Bank in 2024 had increased by 0.67 percent as compared with the preceding year. However, net interest margin of the year under review is lesser than the industry interest margin of 4.6 percent. The reasons for increase of net interest margin of the Bank was the increase of net interest income by a greater percentage than the percentage increase of Average Assets of the Bank.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
<p>(i) Fraudulent Loans granted by the Ampara Branch</p> <p>Ampara branch had granted seven fraudulent Guarantor loans aggregating to Rs.8 million to a private garment factory in year 2017. These loans have been obtained by submitting documents resembling to certain employment details of some of the employees of the company. Subsequently, these loans had been transferred to non-performing category. The total outstanding balance as at 31 December 2024 was Rs.17,104,863.</p>	<p>The Court has nominated Mr. Nirosh as the main accused in the case and directed the collection of his telephone records, as well as the issuance of summons and a warrant. The customer is presently abroad. Next hearing is scheduled for 28/01/2026.</p>	<ul style="list-style-type: none"> • Strengthen the loan approval and monitoring process to prevent granting of fraudulent loans. • Implement stricter internal control and loan mechanism around loan documentation and approval process.
<p>(ii) Nivi Dairy Farm (Private) Limited</p> <p>Nivi Dairy Farm (Private) Limited was incorporated in 2018 and requested loan facilities for the purpose of dairy business. Bank has granted three loans of Rs.20 million (602730000001), Rs.15million (602725000177) and Rs.14,603,274 (602730000002) to the above company for the purposes of purchasing a land, establishing 100 milking cows and working capital requirements. First two loans aggregating to Rs. 35 million had been granted against a immoveable property situated in Kuliypatiya and third loan of Rs.</p>	<p>The English version of the plaint has been received and requires translation for filing. However, since the parties are not residing at the provided addresses, their current addresses need to be determined before proceeding with filing.</p>	<ul style="list-style-type: none"> • Take necessary actions to grant loans and advances to eligible customers in accordance with established circulars and guidelines of the Bank. • Risk assessment process before granting loan should be

14.6 million had been granted against the project assets imported pregnant heifers of Rs 46.9 million and insurance value of 50 million.

These loan had been categorized under stage 3 category on 28 December 2018 and board resolution had been passed on 29 April 2019 to execute parate powers. Mortgaged property had been acquired by the Bank at public auction held on 01 August 2019.

Vested property had been sold by the bank on 08 October 2021 and obtained Rs. 31 million and settled above three loans in following manner.

Loan No.	Total Recoveral Amount	Actually Recovered (Rs.)	Not recovere (Rs.)	Remarks
602725000177	19,914,715	19,914,715	0	Settled
60273000001	31,114,145	11,828,411	19,285,734	Remaining as NPL and filed a court case
60273000002	20,521,095	0	20,521,095	

Further, it was observed that the balance recoverable amount of Rs.39,806,829 had been remain without any mortgage/security. The total outstanding balance as at 31 December 2024 was Rs.71,182,270. (Including total capital with capital arrears Rs. 32,450,954, interest arrears Rs. 14,644,479, OD arrears of Rs. 20,026,497, and charges Rs. 4,060,340).

3.2 Operational Inefficiencies

Audit Issue

i. Employees Provident Fund Loans Rejected by the Central Bank of Sri Lanka

Central Bank of Sri Lanka has rejected the fund release request towards the settlement of 70 Provident Fund loans in year 2022. Out of these loans, funds for the settlement of 52 loans, had been released by the

strengthen.

- Implement stricter monitoring and follow-up mechanisms to minimize future defaults.
- Accelerate the recovery efforts of the Bank

Management Comment

The bank has successfully recovered a significant amount (Rs. 29.27M) from this all portfolio (70 loans). And reaming 15.78 Million

Recommendation

- Strengthen loan monitoring and collection processes to ensure timely repayment of

Central Bank of Sri Lanka for full settlement before 2022. However, the bank has failed to settle the said loans in full from the released funds due to negligence of the bank's staff. It was observed that, various lapses were occurred in the settlement process including, late settlements made for some loans, some were settled in monthly installments instead of full settlements, some loans in the old system were not updated and transferred to the new system and therefore has not been settled, and Form-14 was issued considering the loan balance as zero etc.

As a result of these shortcomings additional interest and penalties had accrued on those loans in subsequent years. The total outstanding balance of 43 Provident Fund loans was Rs.9.46 million as at 31 December 2024, while the remaining 9 loans had been fully recovered by the bank subsequently.

outstanding as at 30.09.2025. Management has approved a clear action plan to clean up the books writing off unrecoverable amounts, making accounting corrections, and actively pursuing recovery and The new process has been introduced to prevent a recurrence of these issues.

EMIs on EPF loans.

- Stricter internal control over settlement process.

ii. The Bank has recovered Past due instalment amounts of EPF back loans from Central bank EPF unit on an annual basis, until such time no sufficient balance in EPF member's account. Out of a 70 EPF loans mentioned in above, 15 EPF loans has been rejected by the Central bank of Sri Lanka due to insufficient funds in the EPF member's account. Reason for 0 balance was the accumulated overdue and interest charges as a result of long period taken for recovery process.

The main reason is an insufficient balance (zero) in the customer's EPF member account, This occurs when a customer fails to pay their monthly installments, causing that installment to become overdue and incurring a penalty interest charge. Annually, HDFC recovers these overdue amounts from the CBSL EPF. If the customer continues not pay their monthly installments or overdue amounts, the balance in their EPF account is depleted, eventually reaching zero.

- Strengthen loan monitoring and collection processes to ensure timely repayment of EMIs on EPF loans.

- Stricter internal control over settlement process.

3.3 Human Resources Management

Audit Issue

i. It was observed that the below mentioned key management positions of the Bank are vacant as

Management Comment

DGM – Credit
• DGM (Credit &

Recommendation

Bank should prioritized the filling

at 31 December 2024.

- General Manager (GM)
- DGM –Credit & Recovery
- AGM –Treasury
- Chief Manager-Branch Operation

Recovery) recruited on 23.06.2025. Considering the cost and banks present situation and restrictions imposed by the CBSL hold to recruit AGM (Credit) & AGM (Recovery).

- Instead of Chief Information Officer and AGM (IT) positions, currently Chief Manager (IT) is heading the department and intend to recruit new Head of IT.

- **Chief Operating Officer**

The Board decided that this position is not required for the bank considering the number of branches and size. (279th Board Meeting held on 30th October 2023) Decided to recruit DGM – Credit and Recoveries and Chief Managers and assigned certain tasks of COO to them and the CEO.

of vacant Key management positions to ensure effective governance. Maintain strong succession plan and clearly define roles and responsibilities for KMPs. Bank should have a timely recruitment process to appoint qualified and competent staff for these posts.

- ii. Except the above Key management Positions, 97 vacancies were exist under senior manager and bellow grade category as at 31 December 2024 including 42 vacancies under executive iii-iii grade category.
- iii. Board of directors' has given their approval for the bellow mentioned new cadre (2025-2026) on 18 March 2025 via Circulation. The comparison between the new approved cadre and the previous cadre is given bellow.

Bank should prioritized the filling of vacant Key management positions to ensure effective governance. Maintain strong succession plan and clearly define roles and responsibilities for KMPs.

Bank should have a timely recruitment process to appoint qualified and competent staff for these posts.

Designation	Grade	New Approved Cadre (2025-2026)	Previous Cadre	Difference
General Manager	GM	1	1	0
Senior Deputy General Manager	SDGM	1	0	1
Deputy General Manager	DGM	3	2	1
Assistant General Manager	AGM	13	4	9
Chief Manager	I	15	11	4
Senior Manager	II	18	15	3
Manager	111-1	57	26	31
Senior executive iii-2 and bellow grade		616	466	150
Total		724	525	199

Following observations are made in this regard.

- a) In the ground of restriction has been imposed on recruitment of new staff by the Central Bank through a letter No.02/18/315/0150/001 dated 30 August 2024, increasing the cadre by 199 positions is debatable. As per the board paper, No.169/2025/CIR submitted to the board of directors, there is no clear requirement mentioned for increasing each position. Eg: AGM positions had been increased from 4 to 13 (225%), Manager iii-1 had been increased from 26 to 57 (119%).
- b) As per the new cadre, 244 number of vacancies are available in the bank as at 31 July 2025. The details are given below.

Grade	New Approved Cadre 2025.06.30	Actual Cadre as at 31.07.2025	Differenc e
GM	1	1	0
SDGM	1	0	1
DGM	3	1	2
AGM	13	4	9
CM-I	15	9	6
SM-II	18	11	7
Manager- 111-1	57	20	37
Senior executive iii-2 and bellow grade	616	434	182
	724	480	244

It was observed that, out of approved new cadre position of 18 numbers relating to Key management personal, 12 positions are vacant as at 31 July 2025. The unavailability of key managerial persons may hinder the effective and efficient operations of the Bank. The details relating to the vacant key managerial positions are given below.

01	DGM (Human Resource)	07	AGM (IS)
02	DGM (Finance)	08	AGM (IT)
03	DGM (Treasury)	09	AGM (Risk Management)
04	AGM (Credit)	10	AGM (Audit)
05	AGM (recovery)	11	AGM (company Secretary)
06	AGM (OPS)	12	AGM (Compliance)

4. Accountability and Good Governance

4.1 Corporate Plan

Audit Issue	Management Comment	Recommendation
(i) As per the Corporate Plan, the Bank has planned to improve shareholder's wealth by increasing Return on Equity by 15 percent during the year 2024. For this purpose bank has expected to	Addressed the concern. During the year 2025, three new products under the Leasing and Guarantor Loan	<ul style="list-style-type: none"> Corporate plan should be prepared by including

change product portfolio mix and introduce new products under leasing, SME and corporate loans. However, the bank has failed to introduce new products in 2024 and ROE reported as (-2.4) percent as at 31 December 2024.

categories have been successfully introduced, while one more product is scheduled for launch on or before the end of November 2025.

Additionally, five sub-product brandings under Sale and Leaseback facilities have been introduced as alternative solutions to mortgage loans, which is currently under regulatory restrictions.

Newly Introduced Products

1. Super Draft Leasing – Introduced on 07.05.2025.
2. Auto Loan (an enhanced version of the Guarantor Loan) – Introduced on 01.07.2025
3. Green Personal Loan – Introduced on 29.07.2025.
4. Green Leasing – Scheduled to be launched on or before 30.11.2025.

Newly Introduced Sub-Product Categories

As alternatives for mortgage loans, the following Leasing-based sub-products have been introduced:

- Biz Leasing
- Edu Leasing
- Home Leasing
- Agri Leasing
- V2V Leasing

Although the new product development process was initiated in 2024, progress was delayed due to challenges such as union actions, product restrictions, and limitations in the marketing budget. Despite these constraints, significant progress has been made in

realistic and measurable targets.

• Factors affected to non-achievement of targets in the corporate plan should be identified.

diversifying the bank's product portfolio to support business growth and market competitiveness.

- (ii) The strategic goal of the bank was bring down the NPL ratio to 30 percent in year 2028 and to 15 percent in year 2024. However, the bank had reported Stage 3 Loans to Total Loan ratio of 45 percent as at 31 December 2024. CBSL imposed restriction on granting EPF backed and Mortgage backed loans. This resulted in the loan portfolio growing negatively. Accordingly, NPL ratio increased despite the NPL capital reducing in 2024 against 2023.
- (iii) The strategy of the bank aims to achieve borrowing to deposit ratio of 40/60 (6.67) in next 5 years period. Even though, the bank has planned to issue Rs.436 million debentures in year 2024 to raise debt capital, the bank has not issued debentures during the year under review. Hence, borrowing to deposit ratio stood as 3.95 as at the end of the year 2024. Due to the existing CBSL restrictions, which was imposed on 31.08.2024, Bank cannot raise the capital via a debenture issue. However, bank raised Borrowing by taking a term loan of 2.0bn from Sampath Bank.

4.2 Effectiveness of Management Information System

Audit Issue	Management Comment	Recommendation
<p>(i) Reliability of Information Systems Application controls are the procedures and functions that ensure the accuracy, completeness, validity, and authorization of data and transactions in an information system. According to the assessment on the effectiveness of application controls to provide assurance on the reliability of the system. Differences in Saving Account balances were observed between the Core Banking System (CBS) and Loan Lease Report Module.</p>	<p>It was observed that differences exist in the Savings Account balances between the Core Banking System (CBS) and the Loan Lease Report Module. However, the Accounts Control Division performs a monthly reconciliation process to ensure the accuracy and reliability of the reported balances. Accordingly, any identified discrepancies are reviewed and rectified as part of this regular reconciliation procedure.</p>	<p>Implement regular reconciliation processes between the CBS and the Loan Lease Report Module.</p>

(ii) Information generated by LMS

a) It was observed that, 448 number of credit facilities included in the system generated loan portfolio shows a principle balance as “zero”. An amount of Rs.10,043,972 had been accrued as interest for those credit facilities as at 31 December 2024 without having a principal balance. The total outstanding balance of those loan facilities was Rs.157,435,740.

Out of above credit facilities, 83 credit facilities have an accrued interest amount of Rs.45,144,182 as at 31 December 2024 which was accrued since over 5 years period. . Further, 23 number of credit facilities have more than Rs.100,000 accrued interest amount.

b) The Loan Management System (LMS) does not automatically post the GL entries for penal accruals. As a result, the finance division manually calculates and posts the GL entries for the accrued penal interest on EPF loans on a monthly basis. This manual process may result omissions and human errors, rather than posting automated GL entries. An accrued penal interest amount of Rs.1,222,701,575 had been posted to the general ledger as at 31 December 2024.

This issue needs to be handled through the IT Division, as it appears to be a system-related or data. The presence of 448 credit facilities showing a zero principal balance while still accruing interest indicates a possible error in the system’s loan data mapping or calculation logic. Therefore, coordination with the IT Division is required to identify the root cause.

The Core Banking System (CBS) processes penal interest on a cash basis; therefore, the Finance Division is not required to manually calculate the accrued penal interest on EPF loans. The Finance Division is only responsible for passing the scheduled balance entries at the General Ledger (GL) level, and not at the individual loan level. These GL entries are reviewed and reconciled with the system records on a monthly basis to ensure accuracy and completeness.

Need to implement an automated process within the Loan Management System (LMS) to automatically post the General Ledger (GL) entries.