



M E M O

FROM: Internal Audit Group

TO: Ag. MD/CE

DATE: 14/10/2016

REPORT ON THE 2016 HALF YEAR INCOME AUDIT

We have carried out the Income Audit for the half year ended 30th June 2016 and the following are some of our findings;

Methodology

To enable us give an informed and incisive opinion on the subject matter, the following methodology was adopted in the discharge of this assignment;

- The trial balance which is the summary of the financial transactions of the Bank from the individual ledger balances as at 30th June 2016 was obtained from FINCON.
- The balances in the Trial Balance were analyzed and comparison was made with the Management Account report that was prepared by FINCON as at 30th June 2016.
- Loan Administration's balances of the individual customers' accounts for EDL, PMBs, MPHS and Home Renovation accounts were also obtained.
- The schedule of repayments/recoveries made during the period was also obtained from Remedial Management Group.
- Compliance and substantive tests were carried out by the team of Internal Auditors in order to validate the data supplied from various sources.

Findings

The following are the key findings;

1. We observed that there was delay in the approval of the 2016 budget and this led to reduced expenditures between January and June 2016.
2. Vetting by Internal Audit Department also contributed to the reduction in the expenditures during the period mentioned above.
3. Postings of expenditure into the general ledger during the previous year (2015) were largely suspended in October 2015 immediately after the Federal Government's directives on Treasury Single Account. Thus, majority of the expenses for the last quarter of 2015 were not captured in 2015 but rather in year 2016.
4. To compound the operational problems, immediately after the approval of the budget those accumulated expenditures of the last quarter of 2015 and those of the first half of the year (2016) were posted into the GL in July 2016.
5. Total Rental Income received by the Bank in the records of Facility Management from January to June 2016 is the sum of **N59,818,490.00** whereas the GL balance as at 30th April 2016 as shown in the Trial Balance is **N70,764,420.86**. On the other hand the sum of **N142,829,273.00** was reported in the Management Accounts as at 30th June 2016.

We however observed that due to renovation works at MKH (the property that generates about 60% of our rental income) the amount of rent earned in 2016 is expected to reduce significantly. Thus, it is not proper for FINCON to accrue for full rental income as if all the tenants in the building are occupying their offices.

6. Total investment portfolio as at 30th June 2016 indicated in the General ledger is the sum of **N33,881,032,778.21** as against the sum of **N29,396,185,720.00** on the investment schedule as at June 2016.

We have however certified the total accrued Interest on Short term Investments reported in the management account as the sum of **N459,899,018.00**.

- Total interest on mortgage assets as at 30th June 2016 as per the trial balance figure is the sum of **N14,055,937,458.19** as against the sum of **N5,561,643,191.00** reported in the Management Accounts.

This simply implies that interest on classified accounts is not being suspended in the Bank's books.

The table below is the summary of all four accounts that generated interest income between Jan and June 2016;

Products	01-January-2016	30-Jun-2016	Variance	Percentage Increase
EDL	87,698,364,507.38	92,788,744,765.66	5,090,380,258.28	5.80%
PMB	2,747,620,603.22	3,320,589,583.24	572,968,980.02	20.85%
MPHS	11,429,147,066.64	14,425,508,337.03	2,996,361,270.39	26.22%
HRL	9,362,858.60	28,030,025.16	18,667,166.56	199.37%

The rising NPLs in EDLs & MPHSs are majorly as a result of the NPLs as there was no significant disbursement for these two account categories during the period. The total sum of **N8,086,741,528.67** is basically the interest capitalized during the period for the two products.

FINCON is advised to reconcile these inconsistencies and readjust the Management Accounts accordingly.

- Deferred restructuring expenses in the sum of **N35,854,680.00** is not being amortised since inception and is being carried forward in the Bank's books. This will further reduce operating surplus reported in the Management Accounts
- The Bank balances in the Trial Balance are worrisome. As reported in our previous routine audit exercises of FINCON/Treasury Groups we observed many balances in the ledger that do not reflect the true and fair position of the Bank's financials.

The table below is an excerpt from the balances on the Trial Balance as at 30th June 2016;

Code	Particulars	Amount
705001	Central Bank of Nigeria (Mainstream)	97,022,014.22
705005	Ecobank Nig Plc, Broad Street	59,581,745.50
705007	Habib Bank	311,202,625.80
705019	Intercity Bank	12,083,027.40
**	**	**
**	**	**
705099	Guarantee Trust Bank	2,381,702.19
		3,372,859,534.84

This further confirms our earlier position as contained in our 2016 half year report where we observed unresolved reconciliation issues with various bank statements especially on E-Collection accounts amounting to the sum of **N15,119,880,051.73**.

10. We also observed unamortized merger imprest for the sum of **N39,221,395.00** that should have been amortised by now still reflecting in the General Ledger as at 30th June 2016. Thus, our profit/income has been significantly over-reported over the years.

11. Management Accounts as at 30th June 2016 indicated a total staff cost of the sum of **N2,646,277.615.00** while the trial balance figure is the sum of **N1,357,707.398.50**.

FINCON is advised to reconcile these inconsistencies and readjust the management accounts accordingly.

On a closer look we observed that the following items that were reported separately in the Management Account (as at 31st March 2016) have all been collapsed into staff cost as at June 2016;

S/N	Details
1	Staff Medicals
2	Transfer Benefits
3	Contribution to Pension Fund
4	Contribution to NHIS
5	Staff Terminal Benefits

It is our view that this will lead to distortion of financial information and will mar decision making by management.

12. Training expenses as at June 2016 Management Account was the sum of **N24,434,100.00** whereas the Trial Balance indicated a total sum of **N620,781,309.49**.
13. Water and Electricity in the Trial balance is the sum of **N153,902,541.65** as against the sum of **N47,282,071.00** in the management account report.
14. Communication Expenses in the Trial Balance was **N49,875,459.31** as against the sum of **N6,614,292.00** in the management account report.

Our Opinion

In view of these findings we hereby wish to express our opinion as follows;

1. Interest on Mortgage Assets reported in the management account includes both performing and nonperforming loans as such we observed misstatement of financial records by reporting the sum of **N5,561,643,191.00** as total interest for the six months period.
2. Interest on Short term Investment was reported under accrual basis of accounting and we are able to confirm that the sum of **N459,899,018.00** was actually earned by the Bank during the period under review as reported in the Management Accounts.
3. Rental Income has been grossly affected by the renovation works at MKH building (the building provides about 60% of the Bank's rental income). Thus it is difficult to issue any opinion on the reported sum of **N142,829,273.00** in the management account as we are of the view that the amount is grossly overstated.
4. Mortgage Loans recovered being the sum of **N1,436,276,055.00** include both repayments and recoveries the accounting treatment of which are different. A detailed analysis is required to separate the repayments portion from the reported figure before such balance can

be considered as income to the Bank after making adjustments to the provisions already made.

Repayments are within the normal cycle of loan as such cannot be regarded as income to the Bank in full.

5. A detailed analysis of other incomes is also required to enable us give an informed opinion on the reported sum of **N64,425,262.00**.
6. Some of the expense heads in the management account represent estimates (e.g. Staff Cost) as such a detailed evaluation of the estimate needs to be carried out to confirm the actual figure.
7. The Trial Balance that is supposed to be the source of our data is not accurate. The trial balance does not truly represent the true and fair view of the Bank's state of affairs and this is of serious concern to internal auditors.

Recommendations

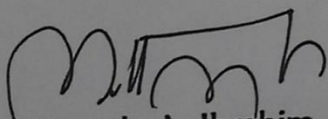
In furtherance to the above, we recommend as follows;

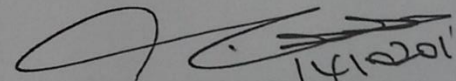
1. Management may wish to direct FINCON to undertake a speedy reconciliation of all outstanding issues in the general ledger in order to reflect the correct financial position of the Bank.
2. Interest on nonperforming loans should immediately be suspended by the Bank in order to reflect the true and fair view of state of affairs of the Bank. Recognizing interest on NPLs exposes the Bank to the risk of overstating its income position.
3. FINCON should be advised to derecognize the unearned portion of the previously recognized interest on mortgage assets so also the Mortgage Loans Recovered to reflect the actual position.
4. Expenses of 2015 should be declassified from 2016 financial year accounts and be recognized in the accounts of 2015 financial year. This

is to ensure that expenses are matched against the income of each particular year (Matching Concept).

5. Management may wish to speed up the process of acquiring full accounting package for the Bank's operation. This will eventually integrate all financial data into one program.
6. Management is advised to review Management Accounts on a monthly basis and to advise all departments to prepare financial reports showing volumes of transactions, interest income, interest expense and general expenses as the case may be as the part of group activities for the month.
7. Management should direct FINCON to investigate all balances in fictitious assets (i.e. merger expenses, restructuring expenses) and advise management for decision making.
8. Management should direct FINCON to adjust the entire management accounts to reflect the true and fair view of the state of affairs.
9. The reported sum of N423,653,187.00 as half year surplus is in our opinion grossly misstated. Thus, management is to direct FINCON to rework the accounts taking note of all our observations.

Thank you.


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cc: ED (Loans & Mortgages)
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