



## नेपाल राष्ट्र बैंक वित्तीय संस्था सुपरिवेक्षण विभाग

### समस्याग्रस्त कर्णाली डेभलपमेन्ट बैंक लि., नेपालगञ्ज, बाँकेको Due Diligence Audit Report सार्वजनिक गरिएको सम्बन्धी सूचना

नेपाल राष्ट्र बैंकको सञ्चालक समितिको मिति २०८१/०९/१० को निर्णयानुसार बाँके जिल्लाको नेपालगञ्ज स्थित कर्णाली डेभलपमेन्ट बैंक लिमिटेडलाई नेपाल राष्ट्र बैंक ऐन, २०५८ को दफा ८६ख. बमोजिम यस बैंकले समस्याग्रस्त संस्था घोषणा गरी सोही ऐनको दफा ८६ग. को उपदफा (२) बमोजिम उक्त संस्थाको व्यवस्थापन आफ्नो नियन्त्रणमा लिएको र उक्त संस्थाको सञ्चालन तथा व्यवस्थापन गर्न यस बैंकबाट तीन सदस्य व्यवस्थापन समूह गठन भई मिति २०८१/०९/११ देखि उक्त समूहबाट संस्थाको सुधार प्रक्रिया क्रमशः अघि बढाइएको छ।

नेपाल राष्ट्र बैंक ऐन २०५८ को दफा ८६च. को उपदफा (१) मा समस्याग्रस्त वाणिज्य बैंक वा वित्तीय संस्थाको नियन्त्रण आफूले लिएको एक वर्षभित्र त्यस्तो वाणिज्य बैंक वा वित्तीय संस्थाको व्यवस्थापन परीक्षण वा लेखापरीक्षण गरी वा गराई सोको प्रतिवेदन सार्वजनिक रुपमा प्रकाशन गर्नुपर्ने प्रावधान रहेकोले व्यवस्थापन समूहद्वारा सञ्जय चौधरी एण्ड एसोसिएटस् नामक चार्टर्ड एकाउन्टेन्ट संस्थामार्फत मिति २०८१ पुस मसान्तको आधारमा उक्त संस्थाको सम्पत्ति तथा दायित्व मूल्याङ्कन (Due Diligence Audit) गरिएकोमा यस बैंकको सञ्चालक समितिको निर्णय बमोजिम संस्थाको Due Diligence Audit Report सम्बन्धित सबै सरोकारवालाहरुको लागि यसैसाथ संलग्न गरी सार्वजनिक गरिएको जानकारी गराइन्छ।

मिति: २०८२/०६/१२

कार्यकारी निर्देशक

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To,  
The Management Team  
Karnali Development Bank Limited  
Nepalgunj, Banke, Nepal

## Subject: Due Diligence Audit Report

Dear Sirs,

We have conducted a Due Diligence Audit (DDA) of Karnali Development Bank Limited (KDBL) as of Poush end 2081, in accordance with the scope of engagement agreed upon. The primary objective of this audit was to assess the financial position, operational performance, and regulatory compliance status of the Bank.

The DDA was carried out based on the available records, documents, and representations provided by the NRB-appointed management team. However, we wish to highlight that due to significant limitations in internal controls, missing financial records, and ongoing investigations into past transactions, the findings of this audit are subject to revision should additional evidence emerge.

## Key Findings and Observations

### 1. Financial Distress and Negative Net Worth

- As of Poush end 2081, the provisional financial statements report a net worth of NPR -1,907,317 thousand. After necessary adjustments and fair valuations, the net worth further deteriorates to NPR -2,467,744 thousand, indicating severe financial distress.
- The Capital Adequacy Ratio has significantly declined to -93.65%, well below the regulatory requirement of 11% for Class "B" development banks.

### 2. Loan and Advances Mismanagement

- Multiple cases of suspected loan misappropriation, unauthorized disbursements, and fraudulent collateral valuations were identified.
- An additional loan loss provision of NPR 431,523 thousand is required for defaulted or irrecoverable loans.



- The estimated recoverable value of loans and interest receivables is 59% of the total outstanding amount, based on collateral valuation (30% weightage to government valuation and 70% to market valuation).

### **3. Suspected Financial Irregularities**

- Embezzlements and unauthorized transactions totaling NPR 1,502,267 thousand were identified, significantly affecting the Bank's financial position.
- Additional suspected embezzlement in inter-bank transactions amounts to NPR 10,051 thousand.

### **4. Non-Banking Assets & Asset Valuation Adjustments**

- The Bank's asset register remains incomplete, with ownership/title verification still in progress.
- Possible realizations from non-banking assets and revaluation gains have been factored into the estimated net worth.

### **5. Regulatory and Compliance Issues**

- The Bank has failed to conduct its Annual General Meeting since FY 2077/78, submit required reports to the Securities Exchange Board of Nepal, and file tax returns on time, resulting in estimated fines of NPR 4,157 thousand.
- Several past financial transactions remain unverifiable due to missing documentation.

### **6. Going Concern Considerations**

Given the negative net worth, severe capital deficiency, regulatory non-compliance, and high exposure to non-performing assets, KDBL faces significant going concern risks. Urgent remedial measures such as capital infusion, asset realization, aggressive loan recovery strategies, and possible merger/acquisition should be explored to restore financial stability.

### **Disclaimer and Scope Limitations**

This Due Diligence Audit was conducted based on the financial records, supporting documents, and management representations available as of Poush end 2081. Given the ongoing investigation into past transactions, the findings and conclusions are subject to further verification and revision. While we have exercised due diligence, we do not assume responsibility for any financial misstatements, fraudulent activities, or omissions that may have occurred under previous management. This report should not be solely relied upon for decision-making without further verification.



## Recommendations and Next Steps

1. **Loan Recovery Strategy:** Immediate actions should be taken to recover non-performing loans through legal enforcement, collateral liquidation, and restructuring agreements.
2. **Capital Restructuring:** Explore options for capital infusion from shareholders, external investors, or financial institutions.
3. **Merger & Acquisition:** Given the financial distress, a strategic merger with a stronger institution should be actively considered.
4. **Operational Restructuring:** Cost optimization measures, strengthened internal controls, and improved governance frameworks are essential for restoring financial stability.
5. **Regulatory Engagement:** Engage with the Nepal Rastra Bank (NRB) to seek possible relief measures, phased compliance strategies, and regulatory exemptions where feasible.

We appreciate the cooperation of the NRB-appointed management team during this audit and remain available for further discussions or clarifications regarding our findings.

Sincerely,

**Sanjay Chaudhary & Associates**

Chartered Accountants

Mahalaxmi-5, Tikathali, Lalitpur, Nepal



Authorized Signatory:

CA. Sanjay Kumar Chaudhary

Principal, Sanjay Chaudhary & Associates

UDIN Number: 250313CA00508z2b7Y

# **DUE DILIGENCE AUDIT REPORT**

**OF**

## **KARNALI DEVELOPMENT BANK LIMITED**

**(BASED ON UN-AUDITED FINANCIALS OF POUSH END 2081)**

**March 2025**

Submitted by:

**Sanjay Chaudhary & Associates**

**Chartered Accountants**

Mahalaxmi-5, Tikathali, Lalitpur  
Aloknagar-31, Kathmandu, Nepal

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## 1. Background of the Organization

### 1.1 Incorporation

Karnali Development Bank Limited (hereinafter referred to as “the Bank” or “KDBL”) is public limited company registered under Companies Act, 2063 of Nepal. The Bank is licensed as per the Nepal Rastra Bank (NRB) as “B” class financial institution to perform financial services as per the Bank and Financial Institutions Act (BAFIA) and its Memorandum and Articles of Association.

The head of the bank is located at Nepalgunj, Banke, Nepal and carries out its financial services through its branches.

The bank accepts deposits, issues loans, issues and processes debit card, is engaged in investing and trading securities, as well as performs other activities set forth in the BAFIA and the Memorandum and Articles of Association of the bank. The company offers range of financial products and services to wide range of client encompassing individuals, mid markets and corporates.

The Bank shares are listed with Nepal Stock Exchange limited and its symbol is KRBL.

### 1.2 Board Members

Details of Board of Directors as on 10<sup>th</sup> Poush, 2081 is as follows:

Name	Designation
Dr. Om Prakash Mishra	Chairman
Yubraj Adhikari	Member
Er. Nishar Ahmad Darjee	Member
Usha Kumari Bhandari	Member
Tank Bahadur Basnet	Member

NRB has suspended the Board on 2081-09-10 and new management team has been formed effective from that date. Other committees have also been ineffective from that date.

### 1.3 Audit Committee

Composition of members of Audit Committee as on 10<sup>th</sup> Poush 2081 is as presented below:

Name	Designation
Yubraj Adhikari	Coordinator
Mukesh Gautam Member	Member
Harihar Prasad Shrestha	Member Secretary

### 1.4 Risk Management Committee

Composition of member of Risk Management Committee as on 10<sup>th</sup> Poush, 2081 is as presented below:

Name	Designation
Tank Bahadur Basnet	Coordinator
Yubraj Adhikari	Member
Mukesh Gautam	Member
Harihar Prasad Shrestha	Member
Raj Kumar Pyakurel	Member Secretary



**1.5 Employee Service Facility Committee**

Composition of Employee Service Facility Committee as on 10<sup>th</sup> Poush, 2081 is as presented below:

Name	Designation
Nishar Ahmad Darjee	Coordinator
Niraj Bikram Shah	Member
Raj Kumar Pyakurel	Member
Mukesh Gautam	Member
Harihar Prasad Shrestha	Member Secretary

**1.6 AML Committee**

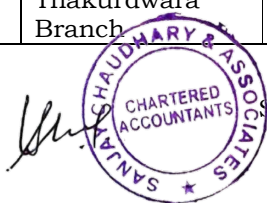
Composition of AML Committee as on 10<sup>th</sup> Poush, 2081 is as presented below:

Name	Designation
Usha Kumari Bhandari	Coordinator
Sunil Srivastav	Member
Raj Kumar Pyakurel	Member
Harihar Prasad Shrestha	Member
Parbat Devkota	Member Secretary

**1.7 Location of Offices**

Corporate Office of KDBL is situated at Nepalgunj Sub Metropolitan City, Nepalgunj, Banke, Nepal and it has expanded its area of operation through opening 18 numbers of branches in Banke, Dang & Bardiya District. It has opened 4 branches in Banke, 8 branches in Dang and 6 branches in Bardiya. Details of each branch are as presented below:

Branch Code	Branch Name	District	Address	Opening Date
001	Head Office	Banke	Nepalgunj, Sub-Metropolitan City Nepalgunj, Banke	2004/02/18
002	Tulsipur Branch	Dang	Tulsipur ka line, Dang	2005/02/17
003	Lamahi Branch	Dang	Lamahi Na.Pa Lamahi Bazzar, Dang	2006/09/17
004	Gulariya Branch	Bardiya	Gulariya Nagarpalika, Bardiya	2007/07/17
005	Bansgadhi Branch	Bardiya	Bansgadhi Na.Pa Bardiya	2008/11/24
006	Bhurigaun Branch	Bardiya	Thakur Baba Na. Pa Bhurigaun, Bardiya	2008/11/24
007	Ghorahi Branch	Dang	Ghorahi U.M.N.Pa Tulsipur Chock	2009/02/12
009	Kohalpur Branch	Banke	Kohalpur Na.Pa. Banke	2009/12/08
010	Khajura Branch	Banke	Khajura Ga.Pa. Banke	2009/12/08
011	Sanoshree Bardiya	Bardiya	Madhuwan Na.Pa. Sanoshree, Bardiya	2009/12/08
012	Bhaluwang Branch	Dang	Rapti Ga.pa Bhaluwang, Dang	2009/12/08
013	Gadhwa Branch	Dang	Gadhwa Ga.pa Gadhwa, Dang	2017/06/20
014	Rajapur Branch	Bardiya	Rajapur Na.Pa Rajapur, Bardiya	2017/06/22
015	Thakurdwara Branch	Bardiya	Thakurdwara Na.Pa. Bardiya	2018/06/22





016	Baijapur Branch	Banke	Rapti Sonari Ga.Pa Baijapur, Banke	2018/07/13
017	Bijauri Branch	Dang	Tulsipur Na.pa Bijauri, Dang	2019/05/22
018	Sisahniya Branch	Dang	Rapti Ga.pa Pipari, Dang	2019/07/11
019	Shamsergunj Branch	Banke	Raptisonari Ga.Pa,Banke	2020/09/17
020	Narayanpur Branch	Dang	Ghorahi U.M.N.Pa Narayanpur, Dang	2022/01/27

### 1.8 Human Resources

KDBL Nepal has the following manpower as of Poush end 2081:

Particulars	As at 10 <sup>th</sup> Poush 2081	
	Number	Status
Manager	2	Permanent
Deputy Manager	3	Permanent
Assistant Manager	2	Permanent
Senior Officer	2	Permanent
Officer	5	Permanent
Junior Officer	6	4 Permanent/ 2 Probation
Supervisor	11	Permanent
Senior Assistant	19	19 Permanent/ 2 Probation
Assistant	16	13 Permanent/ 2 Probation/ 1 Contract
Junior Assistant	38	20 Permanent/ 18 Contract
Clerk	1	Permanent
Driver	1	Permanent
Senior Helper	1	Permanent
Helper	7	6 Permanent/ 1 Contract
Junior Helper	14	2 Permanent/ 12 Contract
<b>Total</b>	<b>128</b>	



## 2. Objective and Scope of Due Diligence Audit

The Due Diligence Audit (DDA) of Karnali Development Bank Ltd. has been conducted to provide a comprehensive assessment of its financial health, operational efficiency, regulatory compliance, and overall risk exposure. The audit aims to evaluate the bank's current standing, identify potential risks, and assess opportunities for future growth and strategic decision-making.

The primary objectives of this audit are as follows:

1. Financial Position Assessment – To analyze the bank's financial statements, including asset quality, liabilities, profitability, liquidity, and capital adequacy.
2. Regulatory Compliance – To ensure adherence to the guidelines set by Nepal Rastra Bank (NRB) and other relevant authorities.
3. Risk Identification – To assess potential financial, operational, credit, and legal risks affecting the bank's stability.
4. Asset & Liability Evaluation – To review the accuracy, quality, and valuation of the bank's loan portfolio, investments, and other assets.
5. Operational & Management Efficiency – To examine internal controls, governance structures, and management effectiveness in overseeing banking operations.
6. Legal & Contractual Review – To assess the bank's legal obligations, pending litigations, and compliance with contractual agreements.
7. Strategic & Growth Potential – To evaluate the bank's market positioning, business prospects, and opportunities for expansion or restructuring.
8. Valuation for Mergers & Acquisitions (if applicable) – To determine the bank's valuation in case of a potential merger, acquisition, or capital restructuring.

The scope of this audit includes the following key areas:

### 1. Financial Due Diligence

- Examination of financial statements, including balance sheet, profit & loss account, and cash flow statements.
- Assessment of asset quality, including loans, advances, and non-performing assets (NPAs).
- Evaluation of liabilities, including deposits, borrowings, and other financial obligations.
- Analysis of capital adequacy, liquidity position, and profitability ratios.
- Verification of financial projections and revenue streams.

### 2. Regulatory & Compliance Review

- Review of compliance with Nepal Rastra Bank (NRB) regulations and banking laws.
- Assessment of adherence to anti-money laundering (AML) and Know Your Customer (KYC) guidelines.
- Examination of statutory filings, tax compliance, and legal obligations.
- Review of corporate governance practices and internal control mechanisms.

### 3. Risk Assessment

- Identification of credit risk, operational risk, market risk, and liquidity risk.
- Assessment of risk management frameworks and mitigation strategies.
- Evaluation of cybersecurity and data security measures.



#### **4. Operational Review**

- Assessment of banking operations, processes, and internal control systems.
- Review of human resource policies, staff efficiency, and organizational structure.
- Evaluation of technology infrastructure, IT systems, and digital banking services.
- Examination of customer service quality and branch performance.

#### **5. Legal & Contractual Review**

- Examination of legal documents, including loan agreements, contracts, and shareholder agreements.
- Review of ongoing or potential litigations and their impact on the bank's operations.
- Assessment of ownership structure, shareholding patterns, and regulatory disclosures.

#### **6. Strategic & Business Evaluation**

- Analysis of market position, competitive landscape, and business growth potential.
- Review of expansion plans, branch network, and product diversification strategies.
- Identification of opportunities for mergers, acquisitions, or strategic partnerships.



### 3. Scope Limitation

While the Due Diligence Audit (DDA) of Karnali Development Bank Ltd. aims to provide a comprehensive assessment, certain limitations may impact the extent and accuracy of the findings. These limitations include:

#### 1. Reliance on Available Information

- The audit findings are based on financial statements, records, and documents provided by the bank. Any undisclosed or incomplete information may affect the accuracy of the assessment.
- The bank has not carried out a statutory audit after FY 2077/78. Financial data used for analysis (e.g., balance sheet, income statement, and cash flow statement) are based on unaudited financial statements as of Poush end 2081. Adjustments may be required if these figures change under statutory audit or further scrutiny.
- The scope does not extend to independently verifying the authenticity of all documents unless specified.

#### 2. Scope of Asset Valuation

- Based on materiality, valuation has been carried out only for land, land and building, vehicles, and machinery with a book value of Rs. 10 lakhs or above. The fair market value has been estimated accordingly.
- Collateral assessment has been conducted only for bad loans of Rs. 1 crore or above as of Poush end 2081, and the fair market value of these collaterals has been estimated.

#### 3. Time Constraints

- Due diligence is conducted within a limited timeframe, which may restrict the depth of analysis in certain areas.
- Due to time constraints we could not obtain external confirmation from the banks and debtors/creditors and we relied upon the representation made by the KDBL in this regard.
- A more detailed forensic audit may be required for deeper investigations into specific financial or operational issues.

#### 4. Market & Economic Factors

- The audit does not account for unforeseen economic fluctuations, regulatory changes, or external market conditions that could impact the bank's financial position in the future.
- Valuation assessments are based on prevailing market conditions and may not fully capture future risks or opportunities.

#### 5. Scope Exclusion of Future Projections

- The audit primarily focuses on historical financial and operational data. Any financial forecasts or projections are subject to inherent uncertainties.
- Future performance depends on management decisions, regulatory changes, and market dynamics, which are beyond the scope of this review.



**6. Legal & Regulatory Limitations**

- The audit does not constitute a legal opinion or detailed forensic investigation of fraud, misconduct, or regulatory violations unless explicitly stated.
- Any pending litigations or legal disputes are assessed based on available case details, and their ultimate outcomes remain uncertain.

**7. Limitations in Assessing Operational Efficiency**

- The audit may not fully capture operational inefficiencies or internal control weaknesses that require long-term observation.
- Employee and management interviews provide insights, but subjective responses may influence the findings.

**8. Access to Confidential Data**

- Certain confidential data, such as customer transactions, sensitive business strategies, and proprietary records, may not be fully accessible for review.
- The audit does not conduct detailed background checks on stakeholders, employees, or external business partners.

While every effort has been made to ensure the accuracy and completeness of this audit, stakeholders should consider these limitations when making strategic decisions. Additional audits, forensic reviews, or expert consultations may be required for specific concerns beyond the scope of this assessment.



#### 4. Methodology and Assumption Adopted for Review

##### 4.1 Methodology

DDA has been conducted using a structured methodology to assess its financial, operational, regulatory, and risk aspects as of Poush end 2081. The key steps in the DDA process are outlined below:

##### 1. Planning & Preliminary Assessment

- Understanding the Scope: Defined the objectives, scope, and limitations of the audit.
- Engagement with Stakeholders: Conducted discussions with the bank's management and key personnel to understand business operations, financial standing, and major risk areas.
- Collection of Preliminary Data: Gathered relevant financial statements, operational reports, legal documents, and regulatory compliance records.

##### 2. Financial Due Diligence

- **Analysis of Financial Statements**
  - Reviewed audited and unaudited financial statements (balance sheet, income statement, and cash flow statement).
  - Assessed financial ratios, liquidity position, profitability, and solvency.
- **Asset & Liability Review**
  - Evaluated loans, advances, deposits, and investments.
  - Identified any non-performing assets (NPAs) and assessed provisioning requirements.
- **Capital Adequacy Assessment**
  - Analyzed the bank's capital structure and compliance with Nepal Rastra Bank (NRB) capital adequacy norms.

##### 3. Asset Valuation

- **Fixed Asset Valuation**
  - Valuation was carried out for land, buildings, vehicles, and machinery with a book value of Rs. 10 lakhs or above.
  - Estimated fair market value based on market conditions and expert opinions.
- **Collateral Assessment for Bad Loans**
  - Collateral valuation was conducted for non-performing loans (NPLs) of Rs. 1 crore or above as of Poush end 2081.
  - Fair market value of pledged assets was determined based on industry standards and market data.

##### 4. Regulatory & Compliance Review

- **Compliance with Nepal Rastra Bank (NRB) Regulations**
  - Verified adherence to banking laws, NRB directives, and statutory requirements.
  - Assessed past regulatory actions or penalties, if any.
- **Other Legal Compliance**
  - Compliance with the Companies Act, 2063.
  - Compliance with the Securities Act, 2063
  - Compliance with the Income Tax Act, 2058
  - Compliance with the Labour Act, 2074



## 5. Risk Assessment

- **Credit Risk Analysis**
  - Reviewed the quality of loan portfolios, credit appraisal processes, and risk mitigation measures.
  - Identified major default risks and their impact on financial stability.
- **Operational Risk Evaluation**
  - Assessed internal control systems, operational efficiency, and governance structures.
- **Liquidity Risk Assessment**
  - Evaluated liquidity position.
- **IT & Cybersecurity Risk**
  - Reviewed the bank's IT infrastructure, digital banking capabilities, and data security measures.

## 6. Legal & Contractual Review

- **Examination of Legal Agreements**
  - Reviewed loan contracts, lease agreements, and other legal documents.
- **Litigation & Dispute Review**
  - Identified ongoing legal cases or potential liabilities affecting the bank.

## 7. Operational & Strategic Assessment

- **Human Resource Review**
  - Evaluated HR policies, and succession planning.

## 8. Reporting & Recommendations

- **Compilation of Findings**
  - Consolidated financial, operational, and risk assessments into a detailed report.
- **Identification of Key Issues & Red Flags**
  - Highlighted financial risks, compliance gaps, and areas requiring corrective action.
- **Recommendations & Action Plan**
  - Provided strategic recommendations for improving financial health, operational efficiency, and regulatory compliance.
- **Presentation to Stakeholders**
  - Shared key findings and insights with the bank's management, or regulatory authorities as required.

### 4.2 Assumptions for Judgment/Estimation & Adjustments

Assumptions and adjustments are made to reflect the best available data, regulatory guidelines, and industry practices at the time of the audit. The conclusions and findings of the DDA are subject to change based on new information or further detailed investigations. Key assumptions and adjustments are:

- Financial data used for analysis (e.g., balance sheet, income statement, and cash flow statement) are based on unaudited financial statements as of Poush end 2081. Adjustments may be required if these figures change under statutory audit or further scrutiny.
- The outstanding loans and advances have been adjusted on the basis of the risk associated with each loan as of Poush end 2081. Loan classification has been considered in accordance with Nepal Rastra Bank (NRB) Directives. Non-performing



loans (NPLs) have been classified according to the guidelines provided by NRB, and adequate provisions have been made based on the risk profiles of these loans.

- Provisions for bad loans and their associated risk assessments were adjusted based on the available NPL data as of Poush end 2081. If any additional bad loans are identified or if recovery rates change, further adjustments may be required.
- Collateral assessments for non-performing loans (NPLs) were based on the assumption that the bank's internal appraisals or documents for bad loans of Rs. 1 crore or above are valid. However, the fair market value might differ due to changes in market conditions or legal disputes over ownership.
- Non-banking assets have been assessed based on the norms fixed by Nepal Rastra Bank. These include assets acquired by the bank in the course of loan recoveries. The potential material shortfall in recovery from non-banking assets, if any, has been highlighted, and recommendations have been made to account for these shortfalls adequately in the financial statements.
- The bank's other assets (such as inventory, receivables, etc.) have been assessed based on factors such as realizable value, age, nature, and the cost associated with disposal. Where applicable, necessary provisions have been recommended to reflect the impairment or obsolescence of any such assets.
- The book values of assets were assumed to reflect their fair value unless market conditions or external appraisals indicated otherwise.
- The assumption for asset valuation was made based on the book value of assets with Rs. 10 lakhs or more, assuming these valuations are a reasonable representation of fair market value. The actual market value of these assets may vary if external appraisers provide updated information or if specific legal and regulatory factors affect their value.
- Land and building valuations are dependent on local real estate market trends, which could fluctuate due to regulatory changes, urbanization, or supply-demand imbalances in the area.
- Fixed assets have been depreciated as per the approved policy of the bank. The depreciation method and useful life have been evaluated based on the bank's internal policies and generally accepted accounting standards. Adjustments may be required if there are inconsistencies in the depreciation policy or if the residual value of assets differs from their carrying value.
- Other liabilities (such as accounts payable, taxes payable, etc.) have been assessed based on the ageing and nature of the obligations to determine the actual liabilities as of Poush end 2081. Necessary provisions for overdue or contingent liabilities have been made, where applicable.
- Employee liabilities, including provisions for retirement benefits, bonuses, and other employee-related expenses, have been assessed based on the existing employee manual and the applicable accounting standards. If such liabilities were not already provided for on an accrual basis, adjustments have been made to reflect the estimated amount of such liabilities based on current practices and projections.
- Contingent liabilities existing as of Poush end 2081 (e.g., ongoing litigation, guarantees, and commitments) have been identified and disclosed in the audit report. If any contingent liabilities are likely to crystallize into actual liabilities, they have been adjusted in accordance with applicable accounting standards and recognized in the financial statements. Adjustments may be needed if further legal issues or liabilities are uncovered.
- The identification of significant risks or "red flags" was made based on financial data, operational procedures, and market conditions. However, additional scrutiny may reveal further risks that could affect the conclusions of the audit.





## 5. Executive Summary of Due Diligence Audit

### 5.1 Abridged Financial Statement

The summary of audit result is presented below. The financial statements for last five fiscal years (2076/77, 2077/78, 2078/79, 2079/80, 2080/81) and for the six month's period ending on Poush End 2081 of FY 2081/82 have been annexed with this report. The financials for FY 2077/78 and FY 2076/77 are audited while the rest of the financials are unaudited/provisional.

### 5.2 Major Suggested Adjustments

Major adjustments considered for DDA in the reinstated financial statements are outlined below:

- a. KDBL has failed to hold annual general meeting from FY 2077/78, submit required reports to the Security Exchange Board of Nepal and file income tax return in time, resulting into estimated fine of NPR 4,157.31 thousands under the Companies Act, 2063, Securities Act, 2063 and Income Tax Act, 2058, has been adjusted in the financial statements for DDA purpose.
- b. Suspected embezzlement in Bank as investigated by the internal auditor of the bank and other unidentified receivables NPR 1,502,267.47 thousands in total has been adjusted in the financial statements for DDA purpose.
- c. Suspected embezzlement in IBT NPR 10,050.54 thousands as investigated by the internal auditor of the bank has been adjusted in the financial statements for DDA purpose.
- d. Computer software NPR 5,012.67 thousands recognized as Depreciable assets has now been derecognized for DDA purpose as already written off in FY 2077/78.
- e. Loss provision NPR 9,549.94 thousands has been created against loans/advances to staffs who are not currently associated with the bank.
- f. Loss provision NPR 65,205.21 thousands has been created against NFRS adjustments, doubtful debtors, prepaid expenses and other receivables.
- g. Adjustment has been made for additional loan loss provision NPR 431,523,412 for loans deemed defaulted or irrecoverable.
- h. Additional gratuity provision fund NPR 5,792.32 thousand has been adjusted for DDA purpose in financial statement as on Poush end 2081.
- i. Provision for employee accumulated leave encashment not provided in financial statement as on Poush end 2081 has been adjusted for DDA purpose with NPR 9,915.75 thousands.
- j. Adjustment of NPR 167,050 has been made against stationery stock discrepancies.



**5.3 Net-Worth Assessment**

As of Poush end 2081, the provisional financial statements report a net worth of NPR -1,907,317 thousand. After necessary adjustments and fair valuations, the net worth further deteriorates to NPR -2,467,744 thousand, indicating severe financial distress. The net worth calculation is summarized in the table below:

Particulars	Before Adjustment (NPR '000)	Adjustment (NPR '000)	After Adjustment (NPR '000)	Fair Value (NPR '000)	Description
<b><u>Assets</u></b>					
Cash and Cash Equivalent	27,316		27,316	27,316	
Due from NRB	10,901		10,901	10,901	
Loans and Advances to Customer	2,936,668		2,936,668	1,732,634	59% recoverable as per valuation report
Current Tax Assets	23,942		23,942	23,942	
Property Plant and Equipment - Land	45,786		45,786	69,615	As per valuation report
Property Plant and Equipment - Others	103,857		103,857	103,857	
Goodwill and Intangible Assets	5,013	(5,013)	-	-	Already written off in FY 2077/78
Stationery Stock	5,607	(167)	5,440	5,440	Overstatement
Sundry Debtors & Prepaid Expenses	65,205	(65,205)	-	-	NFRS adjustment, others
Accrued Interest Receivable	812,098		812,098	479,138	59% recoverable
Staff Loans/Advances	9,550	(9,550)	-	-	Non-working staffs
IBT Account	10,051	(10,051)	(0)	(0)	Suspected embezzlement in IBT
Non-Banking Assets	57,139		57,139	55,129	Realizable
					Suspected embezzlement in Bank, others
Other Assets	1,559,052	(1,502,267)	56,785	56,785	
<b>Total</b>	<b>5,672,184</b>	<b>(1,592,253)</b>	<b>4,079,931</b>	<b>2,564,756</b>	
<b><u>Liabilities</u></b>					
Deposits from Customers	4,610,468		4,610,468	4,610,468	
Borrowing	103,511		103,511	103,511	
Deferred Tax Liabilities					
Interest Suspense	812,098		812,098	-	
Loan Loss Provision Fund	1,697,630	431,523	2,129,153	-	Additional LLP against default loans
Provision for Non-Banking Assets	57,139		57,139	-	
Gratuity Provision	10,273	5,792	16,065	16,065	Additional provision
Leave Encashment		9,916	9,916	9,916	Recognized as per Staff Bylaws
Other Liabilities	288,384	4,157	292,541	292,541	Fine provision
<b>Total Liabilities</b>	<b>7,579,501</b>	<b>451,389</b>	<b>8,030,890</b>	<b>5,032,500</b>	
<b>Net-worth</b>	<b>(1,907,317)</b>		<b>(3,950,959)</b>	<b>(2,467,744)</b>	
<b>Net-worth per share</b>	<b>(379)</b>		<b>(786)</b>	<b>(491)</b>	



## Loan Adjustments and Recoverability Assessment

### 1. Loan Loss Provision Adjustment

- LLP before adjustment: NPR 1,697,630 thousand
- Additional LLP based on DDA find: NPR 431,523 thousand
- Total adjusted LLP: NPR 2,129,153 thousand

### 2. Recoverable Loans and Interest Outstanding

The estimated recoverable value of loans and interest receivables is 59% of the total outstanding amount, based on collateral valuation (30% weightage to government valuation and 70% to market valuation).

Criteria	Details
Number of sampled loan files (bad loans of NPR 1 crore or above)	49
Total loan outstanding under sampling (NPR)	1,889,474,101
Total interest outstanding under sampling (NPR)	566,602,659
Total loan & interest outstanding under sampling (NPR)	2,456,076,760
Total estimated FMV of collateral (as per valuation for DDA) NPR	1,449,687,912
Possible Recovery Rate (Collateral/Total loan & interest outstanding)	59%

At 59% recovery assumption as per collateral valuation report; recoverable loans NPR 1,732,634 thousand and interest receivable NPR 479,138 thousand have been adjusted for the estimation of final net worth. The collateral valuation report is annexed to this report.

### 3. Other Adjustments for Net-Worth Estimation

- **Possible realization of non-banking assets (NBA):** NPR 55,129 thousand, as per the NBA valuation report, has been adjusted for the estimation of final net worth. The NBA valuation report is annexed to this report.
- **Possible gain on revaluation of land:** The land's fair value has been determined as NPR 69,615 thousand and there is a gain of NPR 23,829 thousand. This gain has been adjusted in the final net worth estimation. The property valuation report is annexed to this report.

## Recommendations

1. **Loan Recovery Strategy:** Implement an aggressive loan recovery strategy to enhance the financial position.
2. **Asset Realization:** Expedite the realization of non-banking assets to improve liquidity.
3. **Capital Restructuring:** Explore options for capital infusion through strategic investors or mergers.
4. **Operational Efficiency:** Optimize operational costs and improve profitability through strategic initiatives.

## Final Remarks

The financial health of KDBL requires immediate attention. While adjustments indicate a lower net worth, potential recoveries and asset realizations provide a pathway to improvement. The bank should focus on proactive financial management strategies, loan recoveries, and restructuring plans to ensure long-term stability and sustainability.



#### 5.4 Capital Adequacy Assessment

As per Nepal Rastra Bank (NRB) directives, Class "B" banks (development banks) are required to maintain a minimum Capital Adequacy Ratio (CAR) of 11%, with at least 6% in Tier 1 (core) capital.

However, as per the provisional financial statements as of Poush end 2081, the CAR stood at -32.80%, significantly below the regulatory requirement. After conducting the DDA, the adjusted CAR deteriorated further to -93.65%.

##### Summary of Capital Adequacy Calculation

Particulars	Unit	After Adjustment	Before Adjustment
Core Capital	NPR	(3,972,931,454)	(1,929,289,783)
Total Capital Fund	NPR	(3,972,931,454)	(1,929,289,783)
Core Capital Ratio	%	-93.65%	-32.80%
Total Capital Fund Ratio	%	-93.65%	-32.80%
Risk-Weighted Exposure	NPR	4,242,282,086	5,882,302,555

##### Conclusion

Based on the above calculations, the bank does not have sufficient capital to absorb potential losses. The negative CAR indicates severe financial distress, raising concerns about the bank's ability to maintain financial stability and resilience in accordance with regulatory requirements.

##### Recommendations & Next Steps

1. **Capital Injection** – The bank must seek immediate capital infusion from existing shareholders or new investors to improve the CAR and meet NRB requirements.
2. **Merger or Acquisition** – Considering the negative CAR, a merger with a financially stronger institution or acquisition by a larger bank may be a viable option.
3. **Regulatory Compliance Measures** – The bank should engage with NRB to explore possible regulatory relief measures or phased capital recovery plans.
4. **Operational Restructuring** – A comprehensive review of the bank's operational expenses, risk-weighted asset distribution, and revenue streams is necessary to improve financial health.
5. **Non-Performing Asset (NPA) Management** – Strengthening loan recovery mechanisms and reducing NPAs can help improve the bank's financial position.
6. **Debt Restructuring** – If applicable, renegotiating liabilities and restructuring existing debt could provide some short-term financial relief.

##### Final Remarks

Immediate intervention is necessary to prevent further financial deterioration and ensure compliance with NRB's capital adequacy requirements. Management should act swiftly to explore the best course of action to restore financial stability.

#### 5.5 Going Concern Assessment

Based on the financial position and capital adequacy assessment, KDBL faces severe **going concern risks** due to the following critical factors:



**Indicators of Going Concern Risk**

1. Negative Net Worth: The net worth of NPR -2,467,744 thousand highlights financial distress, significantly below acceptable thresholds.
2. Severely Negative CAR: The Capital Adequacy Ratio of -93.65% indicates an extreme deficiency in regulatory capital, making it non-compliant with NRB requirements.
3. Accumulated Losses: The bank's retained earnings deficit of NPR -4,504,631 thousand suggests prolonged financial underperformance.
4. Liquidity and Solvency Risks: The bank lacks sufficient funds to absorb potential losses or sustain operations in the long term.
5. Loan Recovery and Asset Quality Concerns: A high volume of non-performing assets (NPAs) increases credit risk and reduces revenue potential.

**Mitigation Measures**

1. Capital Infusion: The bank must immediately secure fresh capital from shareholders or external investors.
2. Mergers & Acquisitions: A merger with a stronger institution may be the most viable solution for survival.
3. Regulatory Support: Engaging with NRB to seek phased capital restoration or relief measures.
4. Operational Efficiency: Reducing costs, optimizing resources, and enhancing revenue generation.
5. Loan Recovery Acceleration: Strengthening NPA recovery efforts to improve asset quality and liquidity.

**Final Remarks**

Immediate action is required to address the serious financial distress faced by the bank. Without capital restructuring, regulatory support, or a merger, continuation as a going concern is highly uncertain. The bank's management must act swiftly to prevent further deterioration and restore financial stability.



**6. Findings of Due Diligence Audit****6.1 Suspected embezzlement in Bank and other receivables**

Suspected Embezzlement in Bank NPR 1,272,163,000 has been investigated by the internal auditor of the bank whereas other receivables NPR 230,104,471.41 was found in the financial statement as of Poush end 2081 as unidentified items. Detail of suspected embezzlement in Bank is as follows:

Bank Name	Withdrawn From Bank But Not Recorded On System	Deposited In System But Not Deposited In Bank	Total
Century Bank	95,500,000	12,000,000	107,500,000
Civil Bank	118,000,000	20,500,000	138,500,000
Himalayan Bank Limited	268,035,000		268,035,000
Laxmi Sunrise	242,828,000		242,828,000
Prabhu Bank Limited	176,800,000	50,000,000	226,800,000
Sanima Bank Limited	157,000,000	50,000,000	207,000,000
Siddhartha Bank Limited	61,000,000	20,500,000	81,500,000
<b>Total</b>	<b>1,119,163,000</b>	<b>153,000,000</b>	<b>1,272,163,000</b>

**Key Observations****1. Embezzlement Breakdown:**

- NPR 1,119,163,000 was withdrawn from the bank but not recorded in the system.
- NPR 153,000,000 was deposited in the system but not deposited in the bank.
- The total suspected embezzlement in the bank amounts to NPR 1,272,163,000.

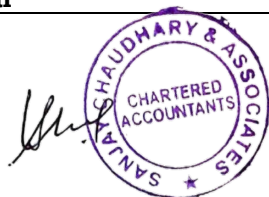
**2. Other Unidentified Receivables:** NPR 230,104,471.41 remains unexplained.**3. Total Financial Impact:** NPR 1,502,267,471.41 is being accounted for as a loss provision in the Profit or Loss Statement.**Suggested Adjustments**

Loss provision NPR 1,502,267,471.41 in total has been charged in Statement of Profit or Loss (SoPL) based on DDA findings.

**6.2 Suspected Embezzlement in Inter Bank Transaction (IBT)**

Suspected Embezzlement in IBT NPR 10,050,541.41 investigated by the internal auditor of the bank was found as unreconciled receivables in the financial statement as of Poush end 2081. Detail of IBT balance as on Poush end 2081 is as follows:

Name	Amount NPR
IBT A/C	-3,179,316.02
Bansgadhi , Bardiya	416,550.00
Bhaluwang Dang A/C	0.01
Bhurigoan A/C	37,858,738.69
Gulariya A/C	-598,341.40
Khajura Banke A/C	-4,750,000.00
Lamahi, Dang	-2,000,000.00
Tulsipur A/C	-17,713.86
Head Office	-37,780,458.82
<b>Total</b>	<b>-10,050,541.40</b>



**Suggested Adjustments**

Loss provision NPR 10,050,541.41 has been charged in Statement of Profit or Loss (SoPL) based on DDA findings.

**6.3 Fixed Assets**

The bank's asset register is incomplete, leading to issues in tracking ownership and title documentation. The bank must update its asset register, ensure proper ownership documentation, and implement stronger internal controls to prevent future misstatements.

**Suggested Adjustments**

Computer software NPR 5,012,672.75 recognized as Depreciable assets in the financial statement as of Poush end 2081 has now been derecognized for DDA purpose due to its prior write-off in FY 2077/78.

**6.4 Uncertain Recovery of Staff Loans and Advances**

The employees of the bank are provided with loan facilities and advances as per the terms of Employees Byelaws. The loan facilities are secured with collateral whereas staff advances are without collateral and recovered by deducting installments from their monthly salary. The detail for outstanding balance of staff loan and advance as on Poush end 2081 is presented below:

MainCode	Staff Loan	Amount NPR
00103000001398000004	Niraj Bikram Shah	1,744,105
00103000001398000006	Niraj Bikram Shah	847,867
00103000001398000033	Niraj Bikram Shah	950,000
00103000001398000036	Niraj Bikram Shah	999,968
00103000002324000005	Sameer Bikram Shah	2,496,950
001030000031848000002	Santosh Shrestha	1,000,000
	<b>Total Staff Loan</b>	<b>8,038,889</b>
	<b>Staff Advance</b>	
966996006	Mahesh Sapkota	11,548
966996020	Narayan Kumar Shrestha	128,847
966996021	Niraj Bikram Shah	1,190,000
966996035	Anita K.C.	45,844
966996039	Sushil Nepal	100,000
966996974	Magan Babu Shrestha	34,812
	<b>Total Staff Advance</b>	<b>1,511,051</b>
	<b>Total Staff Loan &amp; Advance</b>	<b>9,549,940</b>

The above staff loans and advances include the outstanding balance pertaining to the staffs who are not currently associated with the bank. Such amount totals to NPR 9,549,940 which has been deducted from the total outstanding amount as this amount is uncertain to recover.

**Suggested Adjustments**

A 100% loss provision of NPR 9,549,940 has been charged to the Statement of Profit or Loss (SoPL) based on DDA findings.





**6.5 Sundry Debtors and Prepaid Expenses**

Detail of sundry debtors and prepaid expenses is presented below.

<b>Category</b>	<b>Amount (NPR)</b>
Client Insurance Deposit Payable	2,552,005.00
Share Issue Expenses	786,900.74
IME Money Transfer	2,567,151.19
Manakamana Money Express (MME)	1,767,949.42
Prabhu Money Transfer (P) Ltd	0.42
Sewa Money Transfer	278,212.28
City Express Money Transfer Pvt. Ltd	0.17
Prepaid Insurance	20,397.00
Prepaid Expenses	50,000.00
Prepaid Doller Card	42,816.53
Sundry Debtor	2,090,008.14
Interest Suspense NFRS Adjustment	50,829,799.98
Notice Publish Charge	1,415,270.45
ATM Payable	(94,422.00)
ATM Receivable	72,799.00
POS Payable	(220,803.86)
Auction Committee Fee	142,516.63
Samsara Remittance	1.29
Esewa Money Transfer Pvt. Ltd.	1.09
Employee Receivable	46,678.08
Other Expenditure For W/Off	24,664.15
Provision For Other Expenses	1,652,580.00
NBA Provision Expenses	1,180,681.00
<b>Total</b>	<b>65,205,206.70</b>

**Suggested Adjustments:**

- Life insurance premium paid to Union Life Insurance Company on 28/09/2022 towards the life insurance policy of the staff amounting to NPR 2,552,000 has been booked as asset which has been fully adjusted for DDA purpose.
- Right Share issue expenses of NPR 786,900.74 booked as asset instead of Expenses. This amount has been adjusted for the purpose of DDA.
- Receivable from IME Money transfer amounting to NPR 2,567,151.19 has been shown in the books of account. Pending reconciliation and confirmation of balance, this amount has been adjusted for DDA.
- Similarly, receivable from Manokamana Money Express and Sewa Money transfer amounting to NPR 1,767,949.42 and 278,212.28 respectively seem to be doubtful in absence of confirmation and acceptance of the due from the parties. However, the bank has provided for the amount receivable from Manokamana Money transfer due to pending litigation against the party.
- Interest Suspense NFRS Adjustment amounting to NPR 50,829,799.98 has been adjusted as the effect of this has already been given to the previous audited fiscal year.
- Notice published charge of NPR 1,415,270.45 should have booked under the loan accounts of respective borrowers instead of creating receivable asset. Upon inquiry,





the amounts are not traceable with respect to specific borrower. Hence, this amount has not been included in the adjusted financials.

- Meeting fees of NPR 142,516.63 paid to Auction Committee members have been booked as asset instead of expensing the same and thus adjusted for DDA purpose.
- Debit balance of provision for other expenses amounting to NPR 1,652,580 and NBA provision expenses of NPR 1,180,681 have been excluded while preparing the adjusted financials.
- Confirmation not available for sundry debtors NPR 2,090,008.14 has been adjusted for DDA purpose.

## 6.6 Additional Loan Loss Provisioning Adjustments

Nepal Rastra Bank (NRB) mandates that "B" Class Banks (Development Banks) classify loans based on their repayment status and risk level. This classification helps in determining Loan Loss Provisioning (LLP) requirements and managing credit risk effectively.

Based on DDA findings, adjustment has been made for additional loan loss provision NPR 431,523,412 for loans deemed defaulted or irrecoverable as presented below.

Loanee's Name	Amount (NPR)	Reason for Default
Banke Chemicals Pvt. Ltd.	34,378,271	Business not in operation, no collateral
Primefield Agro Pvt Ltd.	48,940,141	Used for unintended purposes
SK Store	59,340,000	Used for unintended purposes
Devaki Agro	79,120,000	Insufficient collateral
R.B.R. Agro	79,120,000	Insufficient collateral
Mata Kalanki Suppliers Pvt. Ltd.	76,000,000	Used for unintended purposes
Dynamic Petplast Industries	36,100,000	Used for unintended purposes
Hotel Chivas	18,525,000	Used for unintended purposes
<b>Total</b>	<b>431,523,412</b>	<b>100% provisioning required</b>

## 6.7 Provision of Employee Benefits

The bank conducted an actuarial valuation for the gratuity fund and leave encashment for the fiscal year 2078/79, and the corresponding liability was recorded in the financial statements. However, no subsequent actuarial valuation has been performed.

For DDA purposes, we have determined KDBL's liability for gratuity and leave encashment as of Poush end 2081, in accordance with the bank's bylaws. A detailed calculation of gratuity and leave encashment is annexed to this report.

- An additional gratuity provision of NPR 5,792,318.82 has been adjusted in the financial statements as of Poush end 2081 for DDA purposes.
- The provision for accumulated leave encashment, which was not recorded in the financial statements as of Poush end 2081, has been adjusted for DDA purposes with an amount of NPR 9,915,748.58.



## 6.8 Deposit Structure Analysis

### 1. Deposit Liability by Type

The bank's outstanding deposit liability is categorized into two major segments: Individual and Institutional deposits.

Type	Amount (NPR)	Percentage
Individual	3,722,848,710	80.75%
Institutional	887,619,217	19.25%
<b>Total Deposit</b>	<b>4,610,467,928</b>	<b>100.0%</b>

Among these, individual deposits dominate the bank's deposit structure, constituting 80.75% of the total deposits.

### 2. Deposit Liability by Deposit Product Type

The classification of deposits based on product type is as follows:

Type	Amount (NPR)	Percentage
Saving	1,728,517,944	37.49%
Current	36,409,368	0.79%
Call	522,854,031	11.34%
Fixed Deposit	2,322,686,584	50.38%
<b>Total Deposit</b>	<b>4,610,467,928</b>	<b>100.00%</b>

Fixed deposits hold the largest share at 50.38%, followed by savings deposits at 37.49%.

### 3. Deposit Liability by Amount Range

The deposit distribution based on deposit size is as follows:

S.N.	Range of Deposits	Amount (NPR)	No of Accounts	Percentage
1	More than 1 crore	611,578,838	26	13%
2	More than 50 Lakh up to one crore	327,469,922	46	7%
3	More than 5 lakh up to 50 lakhs	2,357,978,043	1,907	51%
4	Up to 5 lakh	1,313,441,125	89,432	28%
	<b>Total</b>	<b>4,610,467,928</b>	<b>91,411</b>	<b>100%</b>

- The highest number of depositors (89,432 accounts) fall under the "Up to 5 lakh" category, representing 28% of the total deposits.
- The largest share of deposits (51%) is concentrated in the "More than 5 lakh up to 50 lakh" category.
- Large depositors (above 1 crore) constitute only 13% of the total deposits but represent a significant share of the total amount.



### Key Observations

- **Deposit concentration:** The bank's deposits are concentrated among a small number of large depositors, with the top 10 institutional depositors contributing NPR 567.4 million and the top 10 individual depositors contributing NPR 207.3 million.
- **Retail dominance:** A majority of accounts hold deposits under NPR 5 lakh, but the majority of the deposit amount (51%) is concentrated in mid-range deposits (NPR 5 lakh to 50 lakh).
- **Fixed deposits as a primary source:** Fixed deposits make up 50.38% of the total deposits, indicating a strong reliance on long-term deposits.
- **Institutional deposits:** While institutional deposits constitute 19.25% of the total deposit base, a significant portion is concentrated within a few large entities.
- **Potential risk factors:** The reliance on large depositors increases liquidity risk, and the concentration of fixed deposits requires careful liquidity management.



### Conclusion

The deposit structure of the Bank shows a strong presence of individual depositors, with a notable share of deposits concentrated among mid-range and high-value accounts. The bank relies heavily on fixed deposits, which provide stability but may require strategic liquidity planning. Future efforts should focus on diversifying the deposit base and ensuring regulatory compliance in managing deposit liabilities.

### 6.9 Loans and Advances

Detail of loans and advances as of Poush end 2081 is presented below.

Particulars	After Adjustment	Adjustment	Before Adjustment
Good	554,928,072	(304,245,108)	859,173,180
Watchlist	155,968,329	(137,500,000)	293,468,329
Restructured			
<b>Total Performing Loans</b>	<b>710,896,401</b>	<b>(441,745,108)</b>	<b>1,152,641,509</b>
Substandard	102,916,216		102,916,216
Doubtful	66,667,767		66,667,767
Bad	2,056,187,600	441,745,108	1,614,442,492
<b>Total Non-Performing Loans</b>	<b>2,225,771,582</b>	<b>441,745,108</b>	<b>1,784,026,475</b>
<b>Grand Total</b>	<b>2,936,667,984</b>	<b>-</b>	<b>2,936,667,984</b>
<b>NPL%</b>	<b>76%</b>		<b>61%</b>

#### Non-Performing Loans

After necessary adjustments, the total non-performing loan (NPL) ratio stands at approximately 76% of the total outstanding loans.

### 6.10 Tax Compliance Status

The bank conducted its last statutory audit for the fiscal year 2077/78 on 2080/11/21, and the corresponding tax return was filed on 2080/12/30. This resulted in a net tax liability of Rs. 12,73,128.29, which was adjusted against the advance tax available with the bank. Since then, the bank has not conducted any statutory audits for subsequent fiscal years, and as a result, tax returns have not been filed. Consequently, the bank has outstanding tax payable balances from 2078/79, which will be settled using the bank's advance tax balance in the near future.

The bank has not received any re-assessment order from the Inland Revenue Office for any financial year till the date of our audit. The bank has received last tax clearance certificate for fiscal year 2072/073.

#### Outstanding Tax Liabilities & Fines

Due to non-filing of tax returns on time, the bank is subject to fines under Section 117(1) of the Income Tax Act, 2058. The cumulative late filing penalties are as follows:

Fiscal Year	Fine Amount (NPR)
2077/78	1,134,643.19
2078/79	1,109,433.99
2079/80	707,217.00
2080/81	206,016.25
<b>Total</b>	<b>3,157,310.43</b>



**Suggested Adjustments**

The bank is currently non-compliant with tax regulations due to delayed filings. Cumulative late filing penalties NPR 3,157,310.43 as estimated above has been charged in SoPL based on DDA findings.

**TDS Non-Compliance**

The bank has failed to deposit TDS payable as of Poush end 2081 within the time frame stipulated by the Income Tax Act, 2058. As a result, the bank is subject to fines and penal interest for delayed payments. The breakdown of unpaid TDS as of Poush end 2081 is as follows:

Particulars	Amount (NPR '000)
TDS on staff salary	372.20
TDS on Board Meeting	12.60
TDS on FD	3,948.76
TDS on other services	1,620.78
TDS on house rent	355.92
<b>Total TDS Payable</b>	<b>6,310.25</b>

Bank's failure to deposit TDS amounting to Rs. 6.31 million on time has led to potential penalties and interest liabilities. Immediate corrective action is required to avoid further financial and regulatory risks. Additionally, the bank should implement stronger compliance controls to ensure timely tax filings in the future.

**Penalty & Interest Calculation for Late TDS Deposit**

Under Section 120 (1) of the Income Tax Act, 2058, the following penalties apply for failure to deposit TDS on time:

1. **Late Deposit Fine:** 1.5% of the unpaid TDS per month or part thereof.
2. **Penal Interest:** 15% per annum on the outstanding TDS, calculated on a daily basis.

**Estimated Penalty Calculation**

Assuming the TDS has been overdue for two months, the estimated penalty is calculated as follows:

Particulars	Amount (NPR '000)	Penalty @ 1.5% per month (for 2 months)	Interest @ 15% p.a. (for 2 months)	Total Penalty & Interest
TDS on staff salary	372.20	11.17	9.31	20.48
TDS on Board Meeting	12.60	0.38	0.32	0.70
TDS on FD	3,948.76	118.46	98.72	217.18
TDS on other services	1,620.78	48.62	40.52	89.14
TDS on house rent	355.92	10.68	8.90	19.58
<b>Total</b>	<b>6,310.25</b>	<b>189.31</b>	<b>157.77</b>	<b>347.08</b>

**Total estimated penalty & interest = NPR 347,080** (if overdue by 2 months).

**Note:** The actual penalty will depend on the exact number of overdue days and Inland Revenue Office (IRO) assessment.



**6.11 Compliance Status of the Companies Act, 2063**

Bank has failed to comply with the Companies Act, 2063, due to:

1. Failure to hold Annual General Meetings (AGMs) from FY 2077/78 onward.
2. Non-conduct of statutory audits for subsequent fiscal years.

As per Section 161(h) of the Companies Act, 2063, a penalty of NPR 50,000 per fiscal year is imposed for failure to hold an AGM.

<b>Fiscal Year</b>	<b>Fine Amount (NPR)</b>
2077/78	50,000
2078/79	50,000
2079/80	50,000
2080/81	50,000
<b>Total Penalty</b>	<b>200,000</b>

**Regulatory Risks:** Violation of Section 76 & Section 108 of the Companies Act regarding AGM and financial reporting.

**Financial & Operational Risks:** Additional fines or penalties if delays continue. Possible negative impact on investor confidence and shareholder relations.

**Suggested Adjustments:**

The cumulative penalty of NPR 200,000 has been charged in the SoPL based on the DDA findings.

**6.12 Compliance Status of the Securities Act, 2063**

Bank has failed to comply with the Securities Act, 2063, due to:

3. Failure to submit regulatory reports to the Securities Exchange Board of Nepal from FY 2077/78 onward.
4. Non-conduct of statutory audits, leading to missing financial disclosures.

As per Section 101(4) of the Securities Act, 2063, a penalty of NPR 200,000 per fiscal year is imposed for failure to submit reports.

<b>Fiscal Year</b>	<b>Fine Amount (NPR)</b>
2077/78	200,000
2078/79	200,000
2079/80	200,000
2080/81	200,000
<b>Total Penalty</b>	<b>800,000</b>

**Regulatory Risks:** Violation of reporting requirements under SEBON regulations, increasing the risk of legal enforcement actions.

**Financial & Operational Risks:** Higher fines if non-compliance continues. Possible Delays in financial reporting & statutory audits could lead to difficulty in raising capital.



**Suggested Adjustments:**

The cumulative penalty of NPR 800,000 has been charged in the SoPL based on the DDA findings.

**6.13 Stationery Stock Discrepancies**

As per the Trial Balance of Poush end, 2081, the recorded stationery stock is NPR 5,606,667. However, the actual stock available at various branches differs from the trial balance figure. Branch-wise discrepancies include overstatements and understatements, with total adjustments of NPR 167,050 required. Detail of branch wise stationery stock is given below.

NPR' 000

S.N.	Branch Name	Actual Stock as on 29th Poush, 2081	Adjustment	Stock as per Trial balance as on 29th Poush, 2081
1	Head Office, Nepalgunj	4,458.71	(0.85)	4,457.86
2	Rajapur, Bardiya	61.44	-	61.44
3	Lamahi	58.11	0.12	58.23
4	Kohalpur	44.36	33.19	77.55
5	Tulsipur	23.53	46.68	70.21
6	Sisahnaya	50.52	-	50.52
7	Shamshergun	67.22	20.84	88.07
8	Gulariya	55.87	-	55.87
9	Ghorahi	13.76	-	13.76
10	Gadhwa, Dang	59.33	-	59.33
11	Bijauri	55.00	34.44	89.44
12	Bhaluwang	67.16	0.00	67.17
13	Bansgadhi	35.75	-	35.75
14	Thakurdwara	61.82	19.39	81.21
15	Sonasshree, Bardiya	43.90	12.97	56.87
16	Khajura	66.35	0.27	66.62
17	Baijapur, Banke	73.75	-	73.75
18	Bhurigaun, Banke	35.60	-	35.60
19	Narayanpur	107.52	(0.09)	107.43
<b>Total</b>		<b>5,439.61</b>	<b>167.05</b>	<b>5,606.67</b>

**6.14 Contingent Liabilities & Pending Litigations**

KDBL has significant contingent liabilities and legal risks, including NPR 149.88 million in irrevocable loan commitments and NPR 103.19 million in legal liabilities. Urgent action is required to clear tax compliance backlogs, strengthen legal defenses, and enhance regulatory reporting. Summary of contingent liabilities is presented below.

Category	Details	Amount (NPR '000)
Guarantee Commitments	Irrevocable loan commitments/undrawn limits of overdrafts	149,883
Income Tax Liabilities	Unfiled tax returns since FY 2078/79	Yet to be determined
Pending Litigation	7 court cases with potential liability	103,198
Other Contingent Liabilities	No additional liabilities declared	N/A



**A. Guarantee Commitments Risk**

- The irrevocable loan commitments and undrawn overdraft limits of NPR 149.88 million represent off-balance sheet risks.
- If these commitments materialize, the bank may face liquidity challenges.

**B. Income Tax Contingency Risks**

- No statutory audits have been conducted after FY 2077/78, resulting in unfiled tax returns.
- While the bank has an advance tax balance, the exact outstanding liability is unclear due to pending filings.
- Regulatory Risk: If the tax authorities assess penalties or interest, the financial impact could be significant.

**C. Legal Liabilities – Pending Litigation**

- 7 ongoing court cases with a potential financial impact of NPR 103.19 million.
- Legal & Reputational Risk: If adverse rulings occur, the bank may need to provision significant funds, affecting financial stability.
- Lack of Litigation Strategy: No clear contingency plan for legal disputes is outlined.

**D. Compliance Risks**

- Regulatory Oversight: Delayed financial reporting and tax filings could lead to fines, penalties, or restrictions by regulators (NRB, SEBON, and the Inland Revenue Office).
- Disclosure Issues: SEBON and NRB may require more transparency on litigation and tax contingencies.





## 7. Others

### 7.1 Corporate Governance

Corporate Governance Due Diligence Review of KDBL reveals significant shortcomings leading to regulatory intervention.

#### Regulatory Intervention

On 2081-09-10, Nepal Rastra Bank (NRB) declared KDBL a "troubled institution" and assumed its management. This action was prompted by financial irregularities and governance issues.

#### Identified Governance Issues

1. **Capital Adequacy:** KDBL failed to maintain the minimum required capital adequacy ratio, compromising its financial stability. As per the provisional financial statements as of Poush end 2081, the CAR stood at -32.80%, significantly below the regulatory requirement. After conducting the DDA, the adjusted CAR deteriorated further to -93.65%.
2. **Non-Performing Loans (NPL):** The bank's NPL ratio escalated to 76%, indicating poor credit risk management.
3. **Liquidity Crisis:** Inadequate liquidity management led to the bank's inability to meet deposit obligations.
4. **Financial Irregularities:** Suspected financial misappropriations raised serious concerns about internal controls.
5. **Weak Corporate Governance:** The bank exhibited deficient governance practices, undermining stakeholder confidence.
6. Absence of AGM since FY 2077/78, no statutory audit completed after FY 2077/78.

#### Regulatory Actions

- **Management Takeover:** NRB assumed control of KDBL's management to protect depositors and maintain financial stability.
- **Trading Suspension:** Securities Board of Nepal (SEBON) suspended trading of KDBL's shares, reflecting the bank's compromised financial health.

#### Implications

- **Stakeholder Impact:** Depositors and shareholders face uncertainty regarding their investments.
- **Industry Reputation:** The incident highlights vulnerabilities in the banking sector's governance frameworks.

#### Recommendations

1. **Governance Reforms:** Implement robust governance structures with clear accountability.
2. **Risk Management:** Strengthen credit risk assessment and monitoring processes.
3. **Regulatory Compliance:** Ensure adherence to NRB's capital and liquidity requirements.
4. **Transparency:** Enhance disclosure practices to rebuild stakeholder trust.
5. **Financial Management:** Complete audits, reconcile financial records.



## 7.2 Human Resource Management

Human Resource Management Due Diligence Review of KDBL reveals compliance gaps as identified below:

### 1. Non-Registration of Internal Bylaws

- KDBL has not registered its internal bylaws with the Labor Office, leading to non-compliance with labor regulations.
- Employees lack formal access to policies governing their rights and responsibilities.

### 2. Absence of Health & Safety Policies

- The bank has not established a Health & Safety Committee, which is required to ensure a safe and secure workplace.
- No documented workplace safety policies, emergency response plans, or safety audits exist.

### 3. Gratuity Not Deposited in Approved Retirement Fund

- KDBL has not deposited staff gratuity with an approved retirement fund (e.g., Social Security Fund or other regulated retirement schemes).
- This violates labor regulations and poses financial risks to employees.

### 4. No Paternity Leave Policy

- KDBL has not implemented a paternity leave policy, which is a standard employee welfare practice in many financial institutions.
- This could negatively impact employee morale and workplace inclusivity.

### 5. Labour Audit Not Conducted

- The bank has never conducted a Labour Audit, which is mandatory under labor laws.

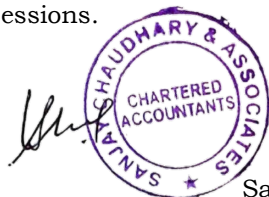
### 6. No Succession Planning

- Nepal Rastra Bank (NRB) and corporate governance frameworks emphasize the need for succession planning in financial institutions.
- The absence of a formal succession plan at KDBL creates a leadership vacuum in case of unexpected departures of key personnel.
- The bank faces a high dependency on a few individuals, increasing operational risks.

## Recommendations for Compliance & HR Improvements

### 1. Register Internal Bylaws with the Labor Office

- Ensure immediate registration and distribution of bylaws to all employees.
- Communicate key provisions of bylaws through awareness programs and training sessions.



**2. Establish Health & Safety Committee & Conduct Regular Audits**

- Form a dedicated Health & Safety Committee with quarterly meetings.
- Implement workplace safety training, periodic risk assessments, and emergency preparedness drills.

**3. Initiate Registration & Contribution to an Approved Retirement Fund**

- Register all employees for gratuity deposit schemes in compliance with the Labour Act, 2074.
- Start monthly contributions to the Social Security Fund (SSF) or any other approved retirement scheme.

**4. Introduce a Paternity Leave Policy**

- Align policies with industry best practices by granting paternity leave benefits.
- Enhance employee satisfaction and retention through inclusive HR policies.

**5. Conduct & Submit an Annual Labour Audit**

- Carry out an annual labor audit and submit reports to the relevant authorities.
- Ensure compliance with the Labour Act, 2074 & Labour Rules, 2075 to avoid penalties.

**6. Implement a Formal Succession Plan**

- KDBL must immediately address succession planning gaps to ensure long-term stability, regulatory compliance, and leadership continuity.
- Implementing a structured succession plan will strengthen governance, talent retention, and crisis management.

**7.3 Information Technology****1. Server Infrastructure****Strengths:**

- KDBL operates a mix of modern server operating systems, including Windows Server 2022 and CentOS 7.
- Active Directory (AD) on Windows Server 2022 enhances authentication security.
- Automatic OS updates ensure timely patching.

**Concerns & Risks:**

- Windows Server 2008 R2 is outdated and unsupported, posing security risks.
- No clear server redundancy or hardware refresh cycle.
- Lack of a performance monitoring strategy.

**Recommendations:**

- Decommission Windows Server 2008 R2 immediately.
- Implement a server lifecycle plan for timely upgrades.
- Maintain detailed hardware inventory and monitor performance metrics.



## 2. Disaster Recovery (DR) Site

### Strengths:

- Active DR site in Tulsipur with data replication via Express Cluster X and Microsoft SQL Server 2022.
- Cloud DR initiative is in progress.
- Replication time of 20-30 minutes ensures minimal data loss.

### Concerns & Risks:

- DR drill was last conducted 6 months ago, which may not meet regulatory best practices.
- No mention of comprehensive DR documentation or compliance testing.
- Lack of automated failover mechanisms.

### Recommendations:

- Conduct quarterly DR drills to improve preparedness.
- Implement automated DR failover testing.
- Ensure DR documentation aligns with business continuity standards.

## 3. Data Center Environment

### Strengths:

- Uses humidity and temperature sensors for monitoring.
- Wireless smoke detection systems and fire extinguishers are in place.
- Pest control measures are implemented.

### Concerns & Risks:

- No real-time environmental monitoring.
- Fire suppression is manual (extinguishers only).

### Recommendations:

- Install real-time environmental sensors.
- Upgrade to automated fire suppression systems.

## 4. IT Policies and Compliance

### Strengths:

- IT policy was revised in 2077 (2020-21).
- Employees receive basic IT security training.
- IS Audit and VAPT was carried out in 2078/79 (2021/22).

### Concerns & Risks:

- IT policy partially aligns with NRB guidelines.
- No dedicated Payment System or Cyber Resilience policies.
- Lack of an IT governance framework.
- Manual policy compliance monitoring instead of automated enforcement.



**Recommendations:**

- Fully align IT policies with NRB Guidelines, Payment System Directive, and Cyber Resilience Framework.
- Establish an IT governance framework (e.g., COBIT, ISO 27001).
- Implement automated compliance monitoring tools.
- The NRB IT Guidelines 2012 emphasize regular IT audits (at least once a year) to ensure security, compliance, and operational resilience. Bank must conduct annual audit, test disaster recovery mechanism, and maintain cybersecurity best practices to comply with regulatory standards.

**5. IT Security & Awareness Training****Strengths:**

- Regular IT security sessions for non-IT staff.
- ATM fraud awareness training included in in-house sessions.

**Concerns & Risks:**

- IT staff rarely trained on new threats and vulnerabilities.
- Limited access to cybersecurity training due to geographical constraints.

**Recommendations:**

- Conduct quarterly cybersecurity training for IT staff.
- Utilize online training platforms (Coursera, Udemy, SANS) for remote learning.

**6. Network Infrastructure****Strengths:**

- Updated network diagram is maintained.
- Segmented VLANs enhance network security.
- Uses enterprise-grade firewalls (Sophos XG135, FortiGate).

**Concerns & Risks:**

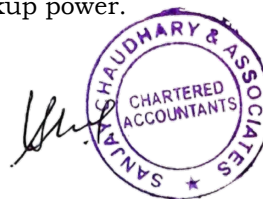
- No detailed report on network services and applications.
- Limited network security monitoring tools (no mention of SIEM, IDS/IPS).

**Recommendations:**

- Maintain detailed device inventory and network service documentation.
- Deploy SIEM or IDS/IPS solutions for proactive threat detection.

**7. Power Backup & Safety****Strengths:**

- 2 UPS systems and a 40 KVA generator provide backup power.
- Backup power lasts 4-6 hours.
- Monthly power system testing ensures reliability.



**Concerns & Risks:**

- No automated alert system for power failures.
- No details on surge protection and electrical safety measures.

**Recommendations:**

- Implement automated power failure alerts.
- Conduct annual electrical safety audits.

**8. Overall Risk Assessment**

Category	Risk Level	Key Concerns
Server Infrastructure	Medium	Outdated servers, no lifecycle plan
Disaster Recovery	Medium	Infrequent drills, limited automation
Data Center Environment	Low-Medium	No real-time monitoring, manual fire suppression
IT Policies & Compliance	High	Partial compliance, lack of governance
IT Security Training	Medium	IT staff training gaps, limited access
Network Security	Medium	Limited security monitoring details
Power Backup & Safety	Low-Medium	No automated power alerts

**9. Final Recommendations**

- Upgrade outdated servers (Windows Server 2008 R2).
- Increase DR testing frequency and implement automated failover testing.
- Improve environmental monitoring with real-time sensors.
- Fully align IT policies with NRB guidelines and implement a governance framework.
- Enhance cybersecurity training for IT staff with remote learning options.
- Deploy a SIEM solution for better network security monitoring.
- Automate power failure alerts for better incident response.



**8. Summary, Conclusion and Recommendation****8.1 Key Findings and Observations****1. Financial Distress and Negative Net Worth**

- As of Poush end 2081, the provisional financial statements report a net worth of NPR -1,907,317 thousand. After necessary adjustments and fair valuations, the net worth further deteriorates to NPR -2,467,744 thousand, indicating severe financial distress.
- The Capital Adequacy Ratio has significantly declined to -93.65%, well below the regulatory requirement of 11% for Class "B" development banks.

**2. Loan and Advances Mismanagement**

- Significant instances of suspected loan misappropriation, unauthorized disbursements, and fraudulent collateral valuations have been identified.
- An additional loan loss provision of NPR 431,523 thousand is required for defaulted or irrecoverable loans.
- The estimated recoverable value of loans and interest receivables is 59% of the total outstanding amount, based on collateral valuation (30% weightage to government valuation and 70% to market valuation).

**3. Suspected Financial Irregularities**

- Embezzlements and unauthorized transactions amounting to NPR 1,502,267.47 thousand have been identified, significantly impacting the Bank's financial position.
- Additional suspected embezzlement in inter-bank transactions amounting to NPR 10,050.54 thousand.

**4. Non-Banking Assets & Asset Valuation Adjustments**

- The Bank's asset register remains incomplete, with ownership/title verification still in progress.
- Possible realizations from non-banking assets and revaluation gains were factored into the estimated net worth.

**5. Regulatory and Compliance Issues**

- The Bank has failed to conduct its Annual General Meeting since FY 2077/78, submit reports to the Securities Exchange Board of Nepal, and file tax returns in a timely manner, leading to estimated fines of NPR 4,157.31 thousand.
- Several past financial transactions remain unverifiable due to missing documentation.



## 8.2 Going Concern Considerations

Given the negative net worth, severe capital deficiency, regulatory non-compliance, and high exposure to non-performing assets, KDBL faces significant going concern risks. Urgent remedial measures such as capital infusion, asset realization, aggressive loan recovery strategies, and possible merger/acquisition should be explored to restore financial stability.

## 8.3 Recommendations and Next Steps

1. **Loan Recovery Strategy** – Immediate actions should be taken to recover non-performing loans.
2. **Capital Restructuring** – Explore options for capital infusion from shareholders or external investors.
3. **Merger & Acquisition** – Given the financial distress, a strategic merger with a stronger institution may be a viable solution.
4. **Operational Restructuring** – Cost optimization and improved governance are essential to restoring financial stability.
5. **Regulatory Engagement** – Active discussions with NRB should be initiated for possible relief measures or phased compliance strategies.

