REVIEW OF THE OPERATIONS

AND AFFAIRS OF

CENTURY NATIONAL BANK LIMITED

AND

CENTURY NATIONAL MERCHANT BANK LIMITED

CONFIDENTIAL

Coopers & Lybrand

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# CONTENTS

**EXHIBIT**

## FINDINGS AND CONCLUSIONS

## CENTURY NATIONAL BANK LIMITED

1. As set out in Exhibit III, and Exhibit II, pages 3 and 4, many "liquid assets" as defined in Section 15 (2) of The Banking Act are pledged or lodged with third parties as collateral to support deposits and other liabilities of CNB and other related parties. These assets are therefore not readily available to meet deposits and other liabilities. Borrowings from The Bank of Jamaica have been incurred as a result of the unavailability of liquid assets.

2. As set out in Exhibit II pages 5 through 13, the quality of the loan portfolio is very questionable. The provision for doubtful accounts is understated. An excessive dollar amount of loans in the portfolio are in default. There is an excessive amount of uncollected arrears in interest.

3. Doubtful loans of CNMB have been sold on a guaranteed basis to financial institutions to obtain funds. As set out in Exhibit II, page 4, and Exhibit III, liquid assets of CNB totalling $30 million have been lodged as collateral.

4. As set out in Exhibit II, pages 9 through 13, administrative procedures set out in credit policy manuals are not being adhered to. This results in inadequate review of loans in all stages of administration. Procedures in place need to be significantly upgraded.

5. Large numbers of loans have been consolidated. This has the effect of bringing the loan to a current status often with the recording of additional fee income. Many of these consolidated loans are in default.

6. As set out in Exhibit II, page 6, credit facilities in the form of loans have been granted to companies and individuals in excess of 20% of the capital base which may be contra to Section 13 (1) (f) (i) of The Banking Act, 1992.

7. As set out in Exhibit III, and Exhibit II, page 4, new credit facilities have been granted to its parent company since January 1, 1993 in excess of 5% of the capital base which may be contra to Section 13 (1) (e) (i) of The Banking Act, 1992.

8. As set out in Exhibit II, page 4, and Exhibit III, new credit facilities have been granted subsequent to January 1, 1993 to a group of related companies partially on an unsecured basis in excess of 20% of the bank's capital base which may be contra to Section 13 (1) (f) (ii) of The Banking Act, 1992.

9. As set out in Exhibit II, page 37, a dividend of $17,500,000 was paid in the form of preferred shares to the shareholders when there were sums due and payable to The Bank of Jamaica which may be contra to Section 13 (1) (g) (v) of The Banking Act, 1992. These preferred shares were subsequently redeemed for cash.

10. As set out in Exhibit III, funds totalling $105 million to be deposited to CNB per letter dated February 19, 1993 from Eagle Merchant Bank of Jamaica Limited ("EMBJL") were deposited by, and at Century National Building Society ("CNBS") despite promissory notes and correspondence from CNB to the contrary. Liquid assets of CNB were lodged with EMBJL to support repayment of these deposits. A letter dated March 1, 1993 has now been recieved from EMBJL acknowledging that the funds may be placed in CNBS. The promissory notes and correspondence from CNB and EMBJL are attached as Exhibit IV.

11. As set out in Exhibit II, pages 35 through 37, the capital base of CNB was increased by what management and its external auditors described as "the capitalization of profits". The large majority of these "profits" were generated by the sale of shares of CNMB to Century National Bank Holdings Limited ("CNBH"), the non-arms length holding company of both CNB and CNMB. Profit should not be recognized until a sale is completed to an arms-length purchaser. The consideration for the purchase of these shares was a $280 million debenture taken back by CNB. This loan is in excess of 5% of the Bank's capital base which may be contra to Section 13 (1) (e) (i) of The Banking Act 1992, and in excess of 20% of the Bank's capital base which may be contra to Section 13 (1) (f) (i) of The Banking Act, 1992 This loan has been reduced to $30 million in 1993.

As set out in Exhibit II, page 4, $150 million of the reduction was funded by CNBH by borrowing the amount from Jamaica Money Market Brokers Limited ("JMMB") and lodging liquid assets of CNB as collateral for repayment.

This new credit facility is in excess of 5% of the Bank's capital base which may be in contravention of Section 13 (1) (e) (i) of The Banking Act, 1992 and in excess of 20% of the Bank's capital base which may be contra to Section 13 (1) (f) (i) of The Banking Act, 1992.

The remaining $100 million of the reduction was funded by CNBH by borrowing the money from Life of Jamaica ("LOJ") and lodging assets of CNBS (LOJ Investments funds - $256.616 million market value at February 23, 1993).

The increase in the capital base created by this capitalization of profits is $132,699,347 according to the audited financial statements of June 30, 1992. This increase in the capital base computates to an ability to increase deposits taken by $3,317,758,675.

12. The sale of the shares of CNMB also created additional retained earnings of $115 million in the year ended June 30, 1992. Without this non- arms length sale, retained earnings would be $103,500,000 less after deducting the appropriation to capital reserve of 10% of profit. Therefore, at February 19, 1993 there would be a deficit of $149,155,997.

13. If the Bank's capital base were revised for these latter two items, CNB would have a negative capital base as calculated under The Banking Act, 1992 and would not be able to borrow by way of deposit.

14. As set out in Exhibit II, page 11, the scope of review presently carried out by internal audit functions is inadequate.

15. As set out in Exhibit XII, the strength and depth of Senior Management is inadequate.

16 The level of business acumen of the directors and senior officers is questionable.

17. As set out in Exhibit II, pages 5 and 6, interest continues to be accrued on loans long passed the time one would expect under reasonable prudent lending practices. This has the effect of substantially overstating income, accrued interest receivable, and loans receivable.

18. Certain practices carried on by management and the Bank are not those that are prudently required and demanded in an industry dealing with the public's trust and funds.

19. As set out in Exhibit II, pages 6, 8 and 16, earnings appear to be substantially overstated.

20. As set out in Exhibit II, pages 14 and 36, CNB continues to self-deal. There are substantial related party advances as at the date of our report. A number of these advances are in arrears of principal and interest.

21. As set out in Exhibit II, page 32, substantial letters of credit, etc. have been issued on behalf of related parties.

22. As set out in Exhibit II, page 29, approximately 50% of taxes payable with respect to taxes withheld on deposits are overdue.

23. As set out in Exhibit XIII, $914 million of $1,291 million raised by CNBS from the issuance of shares has been advanced to or on behalf of related parties.

# CENTURY NATIONAL BANK LIMITED

## Balance Sheet

~~as at February~~ 19, 1993

| Report Reference | ASSETS | $ 000 |
|---|---|---|
| I | Cash resources | 559,419 |
| II | Securities | 1,137,346 |
| III | Loans and advances to customers, net of provision for loss | 1,122,291 |
| IV | Due from related parties | 182,724 |
| V | Customers' liabilities under Acceptance, Guarantees & Letters of Credit Per Contra | 1,099,682 |
| VI | Other assets | |
| | Premises, furniture & equipment | 110,212 |
| | Deferred charges | 160,748 |
| | TOTAL ASSETS | 4,372,422 |
| | **LIABILITIES** | |
| VII | Deposit liabilities | 2,682,040 |
| VIII | Cheques in course of payment less those in course of collection | 113,184 |
| IX | Notes payable | 126,963 |
| X | Other liabiities | 81,473 |
| XI | Customers' liabilities under Acceptance, Guarantees & Letters of Credit per Contra | 1,099,682 |
| | TOTAL LIABILITIES | 4,103,342 |
| XII | **SHAREHOLDERS' EQUITY** | |
| | Common stock | 185,000 |
| | Capital redemption reserve fund | 17,500 |
| | Reserve fund | 24,192 |
| | Revaluation reserve | 18,544 |
| | Deficit | ( 46,156) |
| | | 199,080 |
| | Debenture | 70,000 |
| | | 269,080 |
| | TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | 4,372,422 |

## I CASH RESOURCES

Cash resources at 19 February 1993 are summarized as follows:

| | | $ (000) |
|---|---|---|
| Cash | | 51,625 |
| In transit | | 113,836 |
| Due from Banks (demand) | | |
| BoJ | - Statutory | 524,204 |
| | - Current account | (381,424) |
| | - Prudential account | 80,249 |
| Other | | 16,562 |
| Due from banks (time) | | 22,140 |
| Cheques in course of collection | | 118,957 |
| Interest received | | 13,270 |
| | | 559,419 |

Cash resources consist of cash on hand, statutory and current accounts maintained with Bank of Jamaica, and other Bank accounts maintained with other banking institutions local and foreign for the purpose of investment and meeting other financial obligations as they arise.

A review indicated that the bank accounts were not being reconciled on a timely basis. The last completed reconciliation on the BOJ current account and the overseas National Bank account was October 1992.

The differences are as follows:

| | Bal. per G/L 19/2/93 | Bal. per b/statements 19/2/93 | Difference |
|---|---|---|---|
| BOJ Current a/c | (381,424) | (238,231) | (143,193) |
| National Bank a/c | (23,595) | 15,907 | ( 39,502) |

## II SECURITIES

A summary of securities is as follows:

| | $ (000) |
|---|---|
| Jamaican Treasury Bills | 85,413 |
| Jamaican Government Bonds | 276,656 |
| Other Jamaican Government Securities (Deposits) | 220,000 |
| Overseas Securities | 525,625 |
| Other note receivable | 7,000 |
| Interest receivable - securities | 22,652 |
| | 1,137,346 |

The above Bank of Jamaica securities are self-explanatory. The overseas securities comprise investment in Treasury Bills, Global Bonds and Fixed Deposits.

We attach as Exhibit III a schedule of securities owned by CNB separated among certificates of deposit, treasury bills and local registered stock as at February 19, 1993. As can be seen, every piece of security has been lodged as collateral as described on the schedule and elsewhere in this report. These securities are therefore not readily available to meet prescribed liabilities and suggest to the extent they are not available, the Bank of Jamaica should consider varying the method for calculating the average of the liquid assets required as they are authorized to do under Section 15 (5) of the Banking Act. Many of the securities are lodged as collateral to obligations and cannot therefore be made readily available to meet prescribed liabilities. Two Hundred and Eighty Five million dollars is lodged to meet obligations that are liabilities of related third parties. Other securities are pledged as collateral to obtain third party deposits to CNB.

On February 19, 1993, EMBJL placed on deposit with CNB, per its letter attached as Exhibit IV, $105.0m. CNB forwarded an acknowledgement letter (attached as Exhibit IV) and also sent two of its promissory demand notes (attached as Exhibit IV) and also sent two of its promissory demand notes (attached as Exhibit IV). Contrary to instructions, CNB caused the funds to be deposited into CNBS. CNB advised us that EMBJL is aware of this and has now provided a letter from EMBJL confirming this.

The pledging of CNB securities is summarized as follows:

| | Pledged $ (000) | For |
|---|---|---|
| Certificate of dep and stocks | 150,000 | CNBH borrowings |
| Cert. of dep, treasury bills, and stocks | 105,000 | CNBS borrowings |
| Certificate of deposit | 30,000 | CNMB borrowings |
| Cert. of dep., stocks, and treasury bills | 230,000 | CNB deposits |

## III. LOANS AND ADVANCES (CUSTOMERS)

Loans and interest receivable are summarized as follows:

| | | $ (000) |
|---|---|---|
| Demand Loans | - Commercial | 566,999 |
| | - Individuals | 88,149 |
| Overdrafts | | 409,445 |
| Interest receivable (Demand) | | 181,483 |
| | | 1,246,076 |
| Less: provision for loan losses | | ( 123,785) |
| Total | | $1,122,291 |
| Percentage of total assets (excluding letters of credit & letters of guarantee) | | 34.2% |

The above summary does not include loans to affiliates and related parties which are discussed separately in this report.

A review of the demand loans aged delinquent report indicates total demand loans more that 90 days in arrears of $255.811 million. Of this amount, payments totalling $135.498 million are over 90 days in arrears. The total loans in arrears represents 34.2% of the demand loans receivable. Our review of the delinquency report indicates that the majority of these delinquent loans are well in excess of six months in arrears.

The trial balance of the overdraft accounts indicates numerous overdrafts where there has been no payment received from the borrower for significant periods of time. A summary of the last payment dates is as follows.

| Last Payment Received by CNB | Amount of Overdraft |
|---|---|
| | $ (000) |
| Six to twelve months | 25,002 |
| 1 to 2 years | 28,458 |
| 2 to 3 years | 26,061 |
| 3 to 4 years | 50,297 |
| 4 to 5 years | 20,905 |
| | $150,723 |

These loans represent 36.8% of the total overdraft portfolio.

The company continues to accrue interest on delinquent loans which results in an overstatement of income. Prudent business practice dictates that the interest on all loans and overdrafts over 90 days in arrears should cease to be accrued. Total interest income on demand loans and overdrafts for the period July 1, 1992 to February 19, 1993 is $316.629 million, which is 53.8% of total gross revenue of $588.201 million. Delinquent loan interest accrued and taken into income during the period July 1, 1992 to February 19, 1993 approximates $125.247 million if the percentage of delinquent loans to total loans is applied to interest income.

Section 10 (1) (e) (ii) of The Banking Act (1961) and Section 13 (1) (f) (i) of the Banking Act, 1992 limits total credit to any one customer of the Bank to 20% of the Bank's capital base. A review of the loan portfolio indicates that the following loans may breach this provision.

| | $ (000) |
|---|---|
| Fecon (overdraft) | 68,949 |
| Chicks Jamaica Limited (demand) | 16,844 |
| | $85,793 |
| Percentage of capital base | 28.9% |

Both of these companies are owned by Orville Beckford. Both accounts were charged to the provision for loan loss account in January, 1993.

**Loan Loss Provision**

The loan loss provision as at February 19,1993 consists of certain specific accounts and a general provision. The provision is summarized as follows:

| | $ (000) |
|---|---|
| Paradise Beach Resorts | 5,489 |
| Southern Industrial Limited | 4,451 |
| Robojan Limited | 1,662 |
| Multi Project | 2,495 |
| Lorna Gordon & Associates | 2,049 |
| Beckford | 85,995 |
| Other accounts under $1.0 m (22 a/cs) | 6,404 |
| General provision | 15,240 |
| Total | $123,785 |

Our review of the aged delinquency report indicated that of the total loans in arrears, $12.1 million has been included in the loan loss provision above. This indicates that the external auditors would appear to be of the opinion that certain loans not in arrears are also doubtful.

A summary of the overall position of the loans more than six months in arrears is as follows:

| | $ (000) |
|---|---|
| Demand loans in arrears | 255,811 |
| Overdrafts where no deposits have been received for six months or longer | 150,723 |
| | 406,534 |
| Add: Beckford's loan not included in above | 85,793 |
| | 492,327 |
| Less: provision for loan loss | (123,785) |
| Total loans in arrears over six months | $368,542 |

~~As noted above, interest should cease to be accrued on the above loans in arrears. Also~~ required would be an analysis of the assets securing these loans in order to determine the value of the security, and hence the collectability of the loan.

A review of the credit files indicated that needed documentation was either not on the file or difficult to analyze in order to determine the value of the security. Therefore, the collectability of the loans is difficult to determine. Our general conclusion is that there are a significant number of loans which are under secured. Extensive work would have to be undertaken in order to better determine the quantum of further loans that should be provided for, and the amount of the loans that are uncollectible. For an analysis of our findings on reviewing the credit files, please refer to the following:

## Loan Portfolio Review

On February 22, 1993, we were provided with a computer listing of the demand loan and overdraft portfolio.

Our review commenced by identifying loans and overdrafts in excess of $3.0 million. This list consisted of approximately 60 accounts. From this list we reviewed the files of 17 customers picked at random. The loans outstanding in these 17 accounts totalled $274.452 million. For an analysis of these loans, please refer to Exhibit V.

Our findings were as follows:

1. In all cases, files are incomplete and poorly maintained.
2. In some cases, loans were disbursed before the security was in place, contrary to specific instructions from the credit committee to disburse only where all the security was in order.
3. The security to be taken, according to the approval of credit, was not always taken.
4. Loans were made above approved levels.
5. Appraisals were either not obtained to support values or not in the files.
6. There was no systematic regular loan review prepared by the branch (and/or) credit managers after the loans were disbursed These reviews should recommend a course of action based on facts reported.
7. Copies of security are not kept in the credit file.
8. Copies of searches are not kept in the credit file.
9. There is no systematic (diary) follow-up to obtain items such as progress reports, financial statements, net worth, taxes, insurance etc.
10. There are no regular monthly monitoring reports of advances on the file.

11. The terms of credit do not require monthly submissions of progress.

12. ~~There is no standard collection policy in place.~~

13. It appears collections are generally not pursued until arrears are 30/60 days. With the type of advances at CNB, collection procedures should start within days of the loan being in arrears.

14. Interest arrears on the overdraft accounts are capitalized monthly and interest taken into income.

15. Consolidation loans are made capitalizing interest and therefore transferring the account to current status.

16. Interest continues to be accrued on past due accounts and taken into income, contrary to CNB's own credit policies.

17. There are cases of flagrant non payment by the customer, contrary to his agreed loan repayment scheduled.

18. There appear to be inadequate loan provisions made for arrears accounts (See previous discussion).

19. Financial statements to support borrowings are in many cases either non-existent, out dated or inadequately prepared.

20. In most cases, no valuations of security were seen.

21. There is no system in place to determine if customers have loans at other financial institutions and in what priority position CNB's loan would be.

22. It would appear that major borrowing customers are not visited at their place of business by the lending officers to determine if company operations/bank security are in order.

23. No monthly or regular signed reports are on file representing to CNB the levels of assets supporting a credit facility.

24. The internal audit functions/duties and reporting obligations in respect to the review of credits granted and credit files is totally inadequate.

**Century National Bank Existing Credit Policy**

CNB's credit policies were established on April 23, 1992 by a directive from Mr. Crawford. The directive was sent to all staff, enclosed with the credit policy manual. Listed below are the pertinent issues relating to CNB's credit policies.

1. The subject credit policy, although established by Mr. Crawford in April 1992, is not being adhered to. This was confirmed by CNB's Mr. Prince, by CNB's credit department, and our review of certain loan files from the credit department.

2. The bank credit policy, as outlined in the subject manual, is excellent. If CNB was following their own directives, the loan portfolio and CNB in general would be in much better financial position.

3. Listed below are some critical credit policies outlined in the manual which are NOT being followed by the Bank.

    (a) #C-10240-1 - Each branch's credit officer must prepare monthly delinquency reports (watch critical lists) showing all past due items as follows:

(1) Watch list i.e. items past due (30 to 89 days).

(2) Critical list i.e. items past due (90 days and over). These reports are to be sent to the credit department head office for consideration.

(b) **#C-12240-1** - For loans past due ninety days and over, the credit and recoveries department (CRD) will prepare a past due report for submission to the finance credit committee.

(c) **#C-12240-3** - Loans past due one hundred and eighty days (180) are transferred to non-accrual status.

(d) **#C-102801-1** - This policy regarding renegotiation of loans is not being followed.

(e) There is no indication that a "risk classification review process" is taking place as outlined in policy **#C-010300-2.**

(f) **#C-10560-2** - The collections recovery department is to work on problem loans. This department is non-existent. Also, the credit policy regarding loan collections, etc. is not being followed.

(g) **#C-10570** - The loan loss provision reports are to be examined by CNB's finance committee.

## IV. DUE FROM RELATED PARTIES

Loans and advances to affiliates and related parties are summarized as follows. Our review has indicated that these amounts are unsecured, other than the amount due from V. Williams which is partially secured. The security appears to be of little value.

| | Overdrafts $ (000) | Advances $ (000) | Total $ (000) |
|---|---|---|---|
| **Advances to Affiliates** | | | |
| Century National Merchant Bank Limited (CNMB) | - | 22,515 | 22,515 |
| CNB Holdings Limited (CNBH) | - | 30,000 | 30,000 |
| Century National Development Limited (CNDL) | 33,525 | 7,902 | 41,427 |
| Century National Building Society (CNBS) | - | 12,715 | 12,715 |
| Regardless Limited (RL) | 23,528 | - | 23,528 |
| Jamaica Grande Limited (JGL) | 26,631 | - | 26,631 |
| Fordix Limited (FL) | 119 | - | 119 |
| | $83,803 | $73,132 | $156,935 |
| **Loans to Directors** | | | |
| V. Williams | 12,699 | - | 12,699 |
| R. Hadeed (Serv-Wel) | 13,090 | - | 13,090 |
| | $25,789 | - | $ 25,789 |
| Total | $109,592 | $73,132 | $182,724 |

The CNBH debenture has been due since June 30, 1992. For a further discussion on how this receivable was created, please refer to the Shareholders' Equity section of this report.

All of the above advances to affiliates other than the advances of CNBS and FL may be in contravention of Section 10 (1) (d) (ii) and Section 13 (1) (e) (i) of the 1961 and 1992 Banking Act respectively. These sections limit unsecured credit to bank insiders to 2% and 5% of CNB's capital base respectively.

The advance to V. William may contravene Section 10 (1) (d) (iii) and Section 13 (1) (d) (ii) and (iii) of the 1961 and 1992 Banking Act respectively.

Based on information presented to us, V. Williams has not made a deposit to his overdraft account since 1991.

JGL maintains two overdraft accounts at CNB. The largest overdraft account ($21.437 m) has not had a deposit made since May 29, 1991. It should also be noted that pursuant to the promissory note, JGL is to be charged interest at a rate at 53% below the market rate of 50%. This would move the rate to a negative 3%. In spite of this, CNB continues to accrue interest at 16%. For an analysis of the JGL total loan expense and operations, please refer to Exhibit VI.

CNDL has not made a deposit to its overdraft account since May 28, 1992.

CNB should not be self-dealing. Unsecured advances to affiliates and Directors are high risk, and give the wrong impression to the general public whose confidence must be maintained.

Interest is continuing to be charged to the overdraft accounts and taken into income, even though most of the accounts have had no deposits for one year or longer.

An analysis of the underlying security for each of the loans indicates that it would be prudent to record a provision for loss on some of these accounts. Please note that appraisals were not made available to aid us in our analysis. Accordingly, for assets held by the sister companies, we assumed the value of these assets is equal to historical cost. Also, we do not know if the assets of the sister companies have been pledged as security for other loans, other than JGL's assets which are subject to a loan from CARIFA, such loan being secured by a negative covenant.

| | $ (000) |
|---|---|
| CNMB | 7,400 |
| CNBH | 30,000 |
| CNDL | 19,400 |
| JGL | 26,600 |
| V. Williams | 12,700 |
| CNBS | 6,400 |
| | $102,500 |

CNBS maintains a savings account with CNB ($17.859 m as at February 19, 1993) and holds a certificate of deposit with CNB in the amount of $145.000 million as at February 19, 1993.

A major portion of CNMB's assets is its investment in the shares of JGL ($269.594 m). Our analysis of CNMB's net worth, and hence its ability to pay the $22.515 million owed to CNB, is predicated on the assumption that the value of this share investment is equal to CNMB's carrying cost after removing the exchange gain recorded in June, 1992. After repeated requests to the management of CNB and its external auditors, we have not obtained an appraisal of the hotel property. Even though we have assumed the JGL shares are equal to CNMB's cost, the investment is not liquid, and may take a significant length of time to realize.

## V CUSTOMERS' LIABILITIES UNDER ACCEPTANCE

## GUARANTEES AND LETTERS OF CREDIT PER CONTRA

For a discussion of letters of credit and guarantees, please refer to Section XI of this report.

OTHER ASSETS

Premises, furniture and equipment

Fixed assets at 19 February 1993 are summarized as follows:

| | $ (000) |
|---|---|
| Freehold land | 23,085 |
| Buildings | 24,838 |
| Building in process | 13,035 |
| Leasehold improvements | 4,582 |
| Furniture and equipment | 40,570 |
| Motor vehicles | 4,102 |
| | 110,212 |

A review of the fixed assets indicated that there were assets owned by related companies which were included in CNB's fixed assets. They are summarized as follows:

| ASSET | AMOUNT | OWNED BY |
|---|---|---|
| Building in process (Half Way Tree) | 6,260,512 | CNMB |
| Building in process (Negril) | 2,543,862 | CNDL |
| Furniture & equipment (Half Way Tree) | 1,911,916 | CNMB |

These amounts should be transferred to the owners for CNB's cost.

## Deferred Charges

A summary of the deferred charges is as follows:

| | $ (000) |
|---|---|
| Foreign Exchange Losses | 66,942 |
| Prepaid Expenses | 9,245 |
| Organization Expenses | 190 |
| Other Deferred Charges | 9,405 |
| Foreign Exchange Settlement Account | 74,966 |
| | $160,748 |

The foreign exchange loss account represents the difference between the purchase cost of foreign currency and the amount shown as cost in the foreign currency accounts, that is, "the booked rate", which is pegged at 20.50. When the foreign currencies are sold, this account should clear. Therefore, the balance in the account should represent the difference between the cost of the foreign currency on hand, and the booked rate.

An analysis of the foreign exchange loss account as at February 19, 1993 indicates that this account appears to be overstated as follows:

| | | $ (000) |
|---|---|---|
| Total foreign currencies in J$ | | $280,520 |
| Amount charged to the foreign exchange loss account: | | |
| | $\left(\frac{200}{2{,}050} \times 280{,}520 \text{ m}\right) =$ | 27,367 |
| Balance in account | | 66,942 |
| Estimated write-off | | $39,575 |

The foreign exchange settlement account consists of foreign currency transferred from the branches to head office in $US and converted to $J. The external auditor explained that at its inception, these transfers were not being processed correctly such that on the conversion to $J, the branches were showing an overstatement in their offsetting credit transfer to head office. Accordingly, this debit should be offset by the respective branch foreign exchange credit accounts. This explanation appears reasonable although we did not attempt to reconcile this account.

The remaining deferred charges represent prepaid insurance, prepaid taxes, etc. No further work was done on these accounts as the amounts are immaterial and appear reasonable.

## VII DEPOSIT LIABILITIES

Deposit liabilities are comprised of the following:

| | | $'000 | $'000 |
|---|---|---|---|
| Deposits | | | |
| Chequing accounts | | 319,161 | |
| Foreign currency checking | | 20,917 | |
| Savings - Local | | 249,124 | |
| Foreign currency savings | | 187,074 | |
| Certificate of Deposit | - Local | 1,130,495 | |
| | - Foreign currency | 705,398 | 2,612,169 |
| Interest on deposits | | | |
| | Local currency | 58,321 | |
| | Foreign currency | 11,550 | 69,871 |
| | | | 2,682,040 |

A comparison of the above balances with detailed file listings revealed variances in two categories. Category one represents transactions on which additional verification was needed before the subsidiary ledger was updated. These are classified as work-in-progress and are cleared on a daily basis. The second category of variances were found on all foreign currency accounts. In the case of foreign currency chequing accounts, the variance represents approximately 7% of the total given above while the Certificates of Deposit reflected a 5% variance.

The variances in the foreign currency accounts have been attributed to posting errors due to the lack of knowledge by the staff maintaining the system as per discussions with the client. There is a task force presently involved in the investigation and clearance of variances.

With regards to monthly returns to the Bank of Jamaica, the balances per file listings are disclosed as deposit liabilities and differences reflected as part of other payables.

The following rates of exchange have been used for conversion to local currency:

| | | |
|---|---|---|
| US$1 | = | J$20.50 |
| Cdn$1 | = | J16.00 |
| £1 | = | J$32.75 |

The client was unable to provide a deposit listing by size and age as at the balance sheet date, hence the most recent reports available were analyzed. These have been summarized as follows:

<u>Maturities as at 30/1/93</u>

| Period | $'000 |
|---|---|
| 1 month | 137,911 |
| 2 months | 290,317 |
| 3 months | 660,656 |
| 4 months | 24,479 |
| 5 months | 12,449 |
| 6 months | 398,077 |
| 7 months | 2,686 |
| 8 months | 248 |
| 9 months | 771 |
| 10 months | 1,869 |
| 11 months | 1,484 |
| 12 months | 322,081 |
| Total per file listing as at 30 January | 1,853,028 |
| Total per file listing as at 19 February | 1,844,167 |
| Net movement | 8,861 |

Certificates of Deposit as at 24/2/93

| $ | | | ~~No. of~~ Deposits | $'000 |
|---|---|---|---|---|
| 1 | - | 9999 | 501 | 34,244 |
| 10,000 | - | 19,999 | 545 | 52,870 |
| 20,000 | - | 29,999 | 376 | 45,857 |
| 30,000 | - | 39,999 | 218 | 13,331 |
| 40,000 | - | 49,999 | 157 | 19,382 |
| 50,000 | - | 74,999 | 356 | 75,701 |
| 75,000 | - | 99,999 | 162 | 33,206 |
| 100,000 | - | 149,999 | 483 | 130,556 |
| 150,000 | - | 199,999 | 57 | 53,921 |
| 200,000 | - | 299,999 | 232 | 128,123 |
| 300,000 | - | 499,999 | 209 | 145,375 |
| 500,000 | - | 999,999 | 169 | 195,550 |
| 1,000,000 | - | 1,499,999 | 84 | 121,009 |
| 1,500,000 | - | 1,999,999 | 21 | 34,035 |
| 2,000,000 | | and over | 112 | 732,378 |
| | | | 3,682 | 1,815,538 |

| | |
|---|---|
| Balance per file listing as at 19 February | 1,844,167 |
| Balance per file listing as at 24 February | 1,815,538 |
| Net movement | $ 28,629 |

Both the results given above indicate a decline in the level of balances being held on deposits. The level of foreign currency deposits represents a significant portion, approximately 27% of balances with the United States currency being the most significant.

Over the ensuing six-month period, 82% of the balances held on deposit will mature. Included in the above are two deposits amounting to $145.0m in the name of CNBS.

Savings Accounts

A review of and comparison of the savings accounts, both local and foreign currency, indicated insignificant variations between detailed file listings and the control account. The total savings account portfolio amounts to approximately 17% of total balances on deposit and is mainly comprised of accounts of individuals. Interest is payable at the rate of 15%.

Chequing Accounts

At the balance sheet date, the liability under this category was approximately $340m or 13% of total deposit liabilities. The variance between the file listing and the general ledger control account for local currency was 0.5% and represents work-in-progress which are cleared on a daily basis. Interest is payable on all balances greater than $20,000.

Interest Payable

Interest rates on Certificates of Deposits are as follows. Comparative rates being offered by NCB are also shown.

| Deposits | | Century % | NCB % |
|---|---|---|---|
| Less than | $50,000 | 18 - 21) | 18 - 19 |
| 50,000 | 100,000 | ) | |
| | 3 months | 23 ) | 18 - 19 |
| | 6 months - 1 year | 24 ) | |
| 100,000 and over | | 25 ) | |

Savings Account - 15%

Chequing Account - 10% on balance over $20,000.

Interest Payable

Review of interest payable on Certificates of Deposit highlighted the main variation between the file listing and the control account which relates to US currency account (18% of the general ledger total). Of the balance sheet total, $58,535,000 of the detailed listing was received.

## VIII CHEQUES IN THE COURSE OF PAYMENT LESS THOSE IN COURSE OF COLLECTION

The above is comprised of:

| | $ (000) |
|---|---|
| Interest cheques | 2,168 |
| Manager's cheques | 111,016 |
| | 113,184 |

Interest cheques represent unpresented cheques. Upon maturity of deposits, the system transfers interest from the accrued interest file to interest cheques. The subsidiary ledger of the interest cheque account is in the form of a statement which is done on a monthly basis.

Presently, the statements are not in agreement with the control accounts as the statements, since its inception, have been recording the transaction at the point of cashing, hence a debit enters the ledger without any corresponding entry for the transfer of amounts from the interest accrued account. The general ledger, on the other hand, reflects both sets of entries.

A review of the most recent statement available (29 January), reflected a debit balance of $8,798,000 compared to a general ledger credit account balance of $2,142,192.

Another contributory factor to the large variation is that at the introduction of the use of the statement as a subsidiary ledger, the opening balance on the general ledger was not transferred to the statement.

The manager's cheque account performs the function of the bank's operating account. A statement is maintained for each Branch (similar to a customer statement).

A comparison of January's statement reflected a statement balance of $117,220,000 and a general ledger control account of $119,913,000. A credit balance on the control account does not indicate an overdraft situation as lodgements are not recorded in this account, but in the cash account.

| | | $ (000) | |
|---|---|---|---|
| IX. | NOTES PAYABLE | $126,963 | |

The notes payable balance is comprised as follows:

| | | |
|---|---|---|
| Exim Bank | 359 | (a) |
| USAID | 34,894 | (a) |
| Manufacturers Merchant Bank | 50,000 | (b) |
| National Development Bank (NDB) | 9,769 | (a) |
| Agricultural Credit Bank (ACB) | 14,164 | (a) |
| Interest payable - notes payable | 5,529 | (c) |
| Interest payable debenture | 12,248 | (d) |
| | $126,963 | |

a). Exim Bank, USAID, NDB and ACB

These amounts relate to funds received from the indicated institutions for onlending under special programmes and terms.

Basically, an Agreement is in place between CNB and each of the institutions outlining terms of the funding. CNB obtains the funds at rates lower than those charged to the final borrower, thus making a commission.

Periodic reports are sent to the institutions and the balances appear fairly stated.

b). Manufacturers Merchant Bank

This amounts represent an interbank deposit received from Manufacturers Merchant Bank at 27%. The term of the deposit is from 28 December, 1992 to 28 February, 1993. The deposit is secured by stocks and other securities of CNB.

c). Notes Payable - Interest

This relates to accrued interest on notes payable.

e). Debenture Interest Payable

This amount relates to accrued interest on a $70,000,000 debenture held by CBMB. No interest has been paid since the issue of this debenture.

| | | $ (000) | |
|---|---|---|---|
| X. | **OTHER LIABILITIES** | $81,473 | |
| | These are made up as follows: | | |
| | Taxes payable (including payroll deductions) | 27,765 | (a) |
| | Accounts payable | 7,080 | (b) |
| | Unearned commissions | 20,658 | (c) |
| | Unearned interest | 11,548 | (d) |
| | Miscellaneous liabilities | 14,422 | (e) |
| | | $81,473 | |

a). Taxes Payable

This balance is comprised of the corporation's tax provision of $14,219,000 (1992 and 1993), taxes withheld on deposits of $11,778,000 and unpaid payroll statutory deductions. The 1992 portion of the corporation tax is due in March, 1993. Most of the other amounts are overdue as a result of the Bank's cash flow problems.

b). Accounts Payable

This is comprised of miscellaneous payables including legal fees, audit fees and other accounts payable.

c). Unearned Commissions

The balance comprises the unamortized portion of the discount on debts purchased by the bank. Amounts are amortized to profit and loss over the life of the loans.

d). Unearned Interest

This is comprised of unearned interest on loans and other advances to customers deferred to future periods.

e). Miscellaneous Liabilities

We requested a detailed reconciliation of this account from the external auditors but had not received it at the date of this report.

| | | |
|---|---|---|
| XI. | ~~CUSTOMERS LIABILITIES UNDER ACCEPTANCE~~ | $ (000) |
| | GUARANTEES & LETTERS OF CREDIT FOR CONTRA | $1,099,682 |

This balance is broken down as follows:

| | | $ (000) |
|---|---|---|
| A. | Letters of Credit | 154,323 |
| B. | Letters of Guarantee | 945,359 |
| | | $1,099,682 |

These contingent liabilities are normally set up in the ordinary course of business for customers who should sign standard forms setting out conditions and providing related securities. They are entered in the general ledger by approved credit vouchers with debit vouchers for the contra. Detail listings are maintained manually for the open items, but it is apparent that the system is not operating properly as the detail listings in both instances are not reconciled to the general ledger (see below).

| | $ (000) |
|---|---|
| Letters of Credit | $154,323 |

These letters are issued to third parties (mainly overseas) on behalf of customers. The listing provided to support the amount exceeds the general ledger balance by $64,116,591 ($218,439,827 vs $154,223,236) of which $39,907,676 was explained, leaving an unexplained difference of $24,208,915.

Items issued on behalf of directly related parties amounted to $70,800,000 or 45.87% of the balance as follows:

| | | $ (000) |
|---|---|---|
| #50/91 | For Century National Bank | 48,600 |
| #27/93 | For Jamaica Grande Limited | 22,200 |
| | | 70,800 |

| | $ (000) |
|---|---|
| Letters of Guarantee | 945,359 |

Letters of guarantee are set up similar to letters of credit. However, many of them are for local authorities such as the Collector of Customs. The listing provided to support this balance exceeds the general ledger amount by $120,039,027 ($1,065,397,881 vs. $945,358,254). We requested a detailed reconciliation of the difference. It has not yet been provided.

The listing supplied was not complete as far as indicating the names of customers for which letters were issued. Letters issued on behalf of directly related parties where these could be identified on the listing provided amounted to approximately $739,834,695 or 78.26% of the general ledger balance as follows:

| | | $ (000) |
|---|---|---|
| **Various** | Jamaica Grande Limited | $39,884 |
| **27/3/91** | Century National Merchant Bank & Trust Company | 100,000 |
| Century National Merchant Bank & Trust (CNBS) | | 600,000 |
| | | $739,884 |

No evidence of any securities being in place for these contingencies for related parties were seen. These credit facilities issued on behalf of CNMB may be in controvention Section 13 of The Banking Act.

<u>Other Contingencies</u>

~~The Bank has a number of pending litigation claims against it, none of which are~~ provided for in its financial records.

There is also a situation where the bank cashed a fraudulent draft for £333,000 for which it is claiming from its insurers who are denying liability. The Bank is certainly exposed in this area. However, this cannot be quantified.

A summary of the major issues are as follows:

- <u>Senato Shoe Company Limited VS CNB</u>

  This company has filed a suit against CNB for fraudulent misrepresentation, etc.

  The suit is now more or less dormant as the court has ordered the plaintiff to put up security of $200,000 for costs before proceeding. If this is not done, the issue will be struck off after one year (17/6/93).

  The balance outstanding on the loan is $1,254,618 (pr. $69,783, plus interest $1,184,835). A provision for loss of $844,464.21 has been recorded against this account.

- <u>John Sinclair & Related Company VS. CNB</u>

  Sinclair and his group is suing the Bank for fraud and misrepresentation. Plaintiff is claiming that certain funds advanced were never received and a promissory note was forged and that interest charges were not communicated or agreed.

  Peat Marwick is acting for Sinclair and Aoulous Madden for CNB. The matter is to be heard in court.

Sinclair has paid off most of the related loans ($65 m) leaving a balance of $13,086,073 which is being disputed.

At 30/6/92, a provision for loss on these accounts of $1,113,560.57 were recorded.

Midland Case

It is reported that a fraudulent draft for £333,000 was cashed by CNB on behalf of Midland PLC Bank. it is reported that CNB called for clearance which was received but later cancelled when too late.

The Bank claimed from insurers but this has been rejected. No provision has been made for this amount.

Caribbean Steel Company Limited VS CNB

Carib Steel is suing CNB for approximately $7.1 m plus costs for breach of undertaking. CNB had given an undertaking to deliver Jamaican dollars in the amount of the principal claim by Carib Steel with an understanding that the U.S. dollar equivalent would be lodged to a CNB account overseas by a third party. CNB did not honour the undertaking as according to their representatives the U.S. dollar equivalent was not lodged.

Carib Steel is suing for a breach of undertaking and CNB has filed a defence. CNMB is also a co-defendant. The outcome of the case is uncertain at this time.

## XII. SHAREHOLDERS EQUITY

Shareholders Equity is summarized as follows:

| | $ (000) |
|---|---|
| Common Stock | $185,000 |

The common stock balance was compiled as follows:

| | $ (000) |
|---|---|
| Original equity | 30,000 |
| Issued out of profits from extra-ordinary gain | 132,699 |
| Issued out of capital reserves | 22,301 |
| | $185,000 |

| The Shareholders are as follows: | No. of Shares |
|---|---|
| Regardless Limited | 40 |
| Donovan Crawford | 37 |
| Donovan & Alma Crawford | 66 |
| Raymond & Rosemarie Hadeed | 47 |
| Ken Brown | 8 |
| Millsborough Holdings Limited | 8 |
| V. Caple Williams | 8 |
| Alfred & Cynthia Rattray | 5 |
| Staff Trust | 45 |
| CNB Holdings Limited | 1,849,736 |
| | 1,850,000 |

During the company's fiscal year ended 30 June 1992, CNB sold its shares in CNMB to its parent company CNB Holdings Limited for consideration exceeding its book value by $247,699,347 thus accruing an extra-ordinary gain. This gain was credited to profit and loss and $132,699,347 of the amount was converted to common stock. The capital reserve fund as at July 1, 1991 of $22,300,653 was also converted to common stock. The combination of these two conversions increased common stock by $155.000 m for the year ended June 30, 1992. The $22,300,653 capital reserve fund arose from a prior year's revaluation of the shares in CNMB. The valuation support to this transaction was prepared by the auditors and then reported upon by them. We have not been satisfied that the value placed is reasonable.

CNBH issued a debenture for $280,000,000 to CNB as consideration for the purchase. This debenture was subsequently paid down by $250.000 m. CNBH borrowed the money from an arm's length third party. However, $150.000 m of CNB's liquid securities and $100.000 m of CNBS's liquid securities were pledged to the third party who loaned CNBH the money. In effect, CNB paid itself for 150,000M of the gain.

CNB however, contends that the valuation on which the sale was based was below fair market value and thus the gain is justified. Our examination of CNMB's assets indicates that the value of CNMB's shares may be zero. Therefore, the value of CNB's common stock is highly questionable.

| | $ (000) |
|---|---|
| Capital Redemption Reserve Fund: | $17,500 |

During the current fiscal year (92/93), the company issued redeemable preference shares to its shareholders in the amount of $17,500,000. During this same period, the shares were redeemed in cash. As a result, in accordance with the Company's Act, a redemption reserve fund was set up equal to the amount of shares redeemed. The redemption is questionable in that CNB must have retained earnings out of which to issue and redeem the shares.

| | $ (000) |
|---|---|
| Reserve Fund | $24,192 |

This fund is a statutory reserve required under the Banking Act and is compiled by the transfer of at least 10% of profit for each year.

| | $ (000) |
|---|---|
| Revaluation Reserve | $18,544 |

This reserve represents the surplus on the revaluation of the company's fixed assets (land & buildings) during the last fiscal year. The valuations were done by David Delisser & Company.

| | $ (000) |
|---|---|
| Accumulated Deficit | ($46,156) |

The deficit is comprised as follows:

| | $ (000) |
|---|---|
| Retained earnings at 1 July 1992 (audited) | $112,951 |
| Unreconciled | 3,099 |
| Transferred to preference shares and capital redemption reserve fund | (35,000) |
| Loss to date (unaudited) | ($127,206) |
| | ( 46,156) |

| | $ (000) |
|---|---|
| Debenture Payable | |
| | $70,000 |

This debenture dated 16 April 1991 and effective 30 April 1991 is held by CNMB. The debenture accrues interest at 10% and is subordinated to depositors' funds and other creditors claims. Management has informed us that this debenture is included in the company's capital base for statutory purposes.

Principal repayments are due to commence subsequent to 1996, but is redeemable by the year 2002. The debenture is secured by the company's real estate at Eureka Road and Roslyn Hall along with a floating charge. Indications are that the value of the security is significantly less than the debenture, i.e. by more than $60,000,000.