

Sri Lanka Deposit Insurance and Liquidity Support Scheme - 2019

1.1 Opinion

The audit of the financial statements of the Sri Lanka Deposit Insurance and Liquidity Support Scheme (the “Scheme”) for the year ended 31 December 2019 comprising the statement of financial position as at 31 December 2019 and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(3) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Scheme as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the financial statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Scheme’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Scheme or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Scheme’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Scheme is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Scheme.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Scheme's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Scheme's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Scheme to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Scheme and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Scheme has complied with applicable written law, or other general or special directions issued by the governing body of the Scheme ;
- Whether the Scheme has performed according to its powers, functions and duties; and
- Whether the resources of the Scheme had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

2. Financial Review

2.1 Financial Result

(a) According to the financial statements presented, the operations of the Scheme for the year under review had resulted in an after tax surplus of Rs.10.6 billion as compared with the after tax surplus of Rs. 7.7 billion in the preceding year, thus indicating an improvement of Rs. 2.9 billion in the financial results. Increase of interest income from financial instruments by Rs.1.4 billion and decrease of compensation payment by Rs.2 billion were the main reasons attributed for this improvement in the financial results.

(b) According to the statement of the financial position of the Scheme, the balance in the Fund of the Sri Lanka Deposit Insurance and Liquidity Support Scheme as at 31 December 2019 had increased by Rs.10.8 billion or 21 percent to 62.7 billion as compared with the corresponding balance of Rs.51.9 billion as at end of the preceding year.

2.2 Payment made out of the Fund

In terms of Section 9.10 of the Sri Lanka Deposit Insurance Scheme Regulations No. 1 of 2010, the payment of compensation shall come into effect in the case of a suspension/cancellation as ordered by the Monetary Board on or after 01 January 2012. Accordingly, licences of the three member institutions were cancelled during the year 2018 and 2019 by the Monetary Board. According to the information received, compensation valued at Rs. 2,218 million had been paid to the 5,681 depositors of two member institutions out of the above three member institutions up to the end of the year under review. Total balance compensation payable to the 51,635 depositors of the above three member institutions as at the end of the year under review was Rs.1,526 million.

3. Operational Review

3.1 Operational Inefficiencies

	Audit Issue	Management Comment	Recommendation
a.	As per the Section 9.4 of Sri Lanka Deposit Insurance Scheme Regulations No. 1 of 2010, the compensation within the limits as specified will be paid within six months from the date of the cancellation of the licence of the member institution. However, compensation valued at Rs.311 million representing 8 percent of total value of compensation payable had only been paid within six months to the depositors of the three member institutions whose licences were cancelled during the year 2018 and 2019.	Agreed.	To adhere to the stipulated time.
b.	As per the Section 1.3.1(c) of Monetary Board approved compensation procedure, Director of Supervision of Non Bank Financial Institution as the respective regulator shall submit a regulator certified list of depositors to working committee as per the format given by the Scheme. The verification of the accuracy of the certified list of depositors shall be done by the respective regulator directly or through an auditor not later than two months of the date of cancelation of licence of the member institution. However, such a list of depositors was not certified by the regulator with respect to the three member institutions whose licences were cancelled. Monetary Board had granted approval to follow alternate procedures considering the issues raised by the regulator on the inability to submit such regulator certified list of depositors.	Agreed.	To comply with the said procedure.

3.2 Loans to Member Institutions (MIs)

Audit Issue	Management Comment	Recommendation
<p>In terms of Section 8.1(ii) of the Sri Lanka Deposit Insurance Scheme Regulations No. 1 of 2010, secured advances or loans to any MI shall be granted in the instance of a severe liquidity crisis in such member institution. Accordingly, a loan amounting to Rs.6 billion was granted to a MI on 15 December 2014. Receivable amount of the loan as at the end of the year under review was Rs.1.9 billion. Capital repayments and interest payments on the loan were in arrears since the month of March 2020 and the licence issued to the said MI to carry out the finance business was cancelled with effect from 22 May 2020 by the Monetary Board. Further, the market value of the pledged property against the loan granted was Rs.1.187 billion as per the valuation report dated 20 December 2018 and future value of pledged security portfolio against the loan granted as at end of the February 2020 was Rs. 653 million.</p>	<p>Agreed.</p>	<p>To take necessary actions to recover the outstanding loan balance.</p>

3.3 Identified Losses

Audit Issue	Management Comment	Recommendation
<p>A sum of Rs.137.18 million had been invested on 01 April 2015 in Reverse Repurchase Agreement matured on 31 March 2016 for a sum of Rs 147.05 million with a particular primary dealer by the Scheme. The primary dealer had withdrawn the underlying securities of the above investment without substituting any security with respect to withdrawn securities.</p> <p>Then, Monetary Board of the Central Bank had decided to rollover the above investment without having securities as per the Board decision taken on 04 December 2015.</p>	<p>Agreed.</p>	<p>To take necessary actions to mitigate such risk in future and take necessary action to recover the loss.</p>

Accordingly, impairment allowance amounted to Rs.144.25 million for the above investment had been made in the financial statements of the Scheme on 31 December 2015. Even up to 31 December 2019, the above investment is rolling over and unwinding interest on the above investment from 01 January 2016 to 31 December 2019 was Rs. 52.79 million.