

National Savings Bank – 2019

1.1 Opinion

The audit of the financial statements of the National Savings Bank (“Bank”) and the Consolidated Financial Statements of the Bank and its Subsidiary (“Group”) for the year ended 31 December 2019 comprising the statements of financial position as at 31 December 2019 and the statements of comprehensive income , statement of changes in equity and cash flow statement 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 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018 and Finance Act No. 38 of 1971.

In my opinion, the accompanying financial statements of the Bank and the Group give a true and fair view of the financial position of the Bank and the Group as at 31 December 2019, and of their financial performance and 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 Group’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 intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank’s and the Group’s financial reporting process.

As per Section 16 (1) of the National Audit Act No. 19 of 2018, the Group 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 Group.

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 Group'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 Group'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 Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

1.5 Financial Statements

1.5.1 Internal Control over the preparation of financial statements

Audit Issue	Management Comment	Recommendation
Interest receivable on pawning advance balance in the pawning system was different with the general ledger balance by Rs.637 million as at 31 December 2019. Without finalizing the investigation for the above difference, a provision had been made by adjusting the equity balance.	This amount is appeared in the General Ledger as Interest Receivable, which was related to the previous years. Considering the possible losses arising out of the receivable, a provision of Rs.637,405,736/- has been made as at 31/12/2019 as recommended by the Board Audit Committee until the finalization of the investigation.	Provision should be made on reasonable and acceptable basis.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
a) Receivable amount to the Bank from fraudulent withdrawals as at 31 December 2019 was Rs.112.6 million and this is an increase of Rs.2.1 million or 1.9 per cent compared with the previous year. Out of the above balance, a sum of Rs.45.1 million had remained outstanding for over five years period.	A sum of Rs.14.5 Mn. has been recovered out of Rs,112.6 Mn. as at 30/09/2020. Actions are being taken to clear the remaining balances and an adequate provision of Rs.105 Mn. has also been made against the total fraudulent withdrawal of Rs.112.6 Mn. as at 31/12/2019.	Bank should take actions to recover the balance from responsible party or obtain the insurance claim or write off the unrecoverable balance within reasonable time period.

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| <p>b) The Bank had invested in Treasury bond of Entrust Securities PLC in 2016 and the capital and interest receivable balance was Rs.734.79 million as at 31 December 2019 after made a provision of Rs 124.37 million. This provision was equal to the difference of receivable balance and loan payable to above company as at the date of provision</p> | <p>We noted your comments.</p> | <p>Actions to recover the invested amount and interest should be taken by the Bank.</p> |
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1.6.2 Advances

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
<p>a) The total outstanding loans and advance balances as at 31 December 2019 was Rs.458,662 million and out of that Rs.7,224 million or 1.6 per cent shown as non-performing loan and this was Rs.5,212 million or 1.2 per cent in year 2018. Further, out of the above non-performing loan balances, a sum of Rs.390.7 million or 5.4 per cent was remaining outstanding for more than 3 years.</p>	<p>NPA percentage of 1.6% as of 31.12.2019 was comparatively better than the industry average. With regard to the loans in non-performing category for more than 3 years, legal action has been commenced. However, it was halted on the guidelines of the CBSL.</p>	<p>NPA ratio of loans and advance balance of the bank should be keep at a minimum level.</p>
<p>b) Total Pawning Advances granted by the bank as at 31 December 2019 was Rs.34,544 million and market value thereon was Rs.63,353 million. Out of the said total pawning advances, Rs.242.14 million was non performing. Out of that an advance of Rs.18.91 million had remained outstanding over 3 years period.</p>	<p>The NPA ratio of Pawning was below 1% as of 31.12.2019. The advances above 3 years are kept due to special reasons. (Ex: Court cases, audit investigations etc.) The Pawning NPAs have been continuously monitored and regulated by conducting auction sale of unredeemed articles 3 times in 2019.</p>	<p>Bank should take actions to recover the pawning outstanding balance.</p>
<p>c)The file containing the original documents of a loan amounting to Rs.900,000 was misplaced. Said loan has been granted on 11 May 2012 and transferred to non-performing category on 31 October 2012 and the Total outstanding as at 31 December 2019 was Rs.2,428,247. No investigation was carried out against the credit officer who</p>	<p>The Bank is unable to contact the borrower as they have relocated from the place where they were at the time of granting the loan. Action is taken to complaint to the police to locate the borrower.</p>	<p>Bank has a high risk of missing loan files and actions should be taken to implement sound internal control system to reduce above risk.</p>

handles the loan file and no legal action had been taken to recover the loan as per section 8 and 9 of the Loan Recovery Policy of the Bank or from guarantors.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
National Savings Bank Act, No.30 of 1971 Section 47	Deposits which are inoperative over 10 years should transfer to the “Unclaimed Deposits Reserves” account. However it was observed that Rs.933.22 million were remained as dormant in financial statements as at 31 December 2019 without transferring to the said reserve.	The Bank has transferred a sum of Rs.688.5 Mn. lying to the credit of Dormant Accounts to the unclaimed deposit accounts in 2019. Due to the higher percentage of subsequent withdrawal by the customers, the transfers are made annually. The remaining balances will be transferred during the year 2020.	Bank should comply with the requirements of the National Savings Bank Act, No.30 of 1971
ii) Section 47(4)	Payments made by the Bank to customers through the Unclaimed Deposit Reserves Account should be reimbursed from the consolidated fund of General Treasury. Although the bank had paid Rs.524.08 million to customers during the period from 2000-2019, the Secretary to the General Treasury had reimbursed only Rs. 300 million in 2019.	A request has already been made to the General Treasury for the reimbursement of balance Rs.224.08 Mn.	Bank should comply with the requirements of the National Savings Bank Act, No.30 of 1971

2. Financial Review

2.1 Financial Result

The Bank had recorded a net profit of Rs.6,198 million for the year under review as compared with the corresponding net profit of Rs.4,500 million for the preceding year. Accordingly, the operating result of the year under review had been increased by Rs. 2,198 million or 48 per cent compared with preceding year. The reasons for the above increase were increase of net

interest income, net gain from trading, net fee and commission income, net gain from derecognition of financial assets and decrease of impairment charges compared to previous year.

Total interest income of the bank had increased by 7 per cent or from Rs.110,506 million to Rs.118,729 million in the year 2019 due to Rs. 8,192 million or 16 per cent increase in interest income from loans and advances. Interest expenses for the year had been increased by 5 per cent due to increase of interest paid on deposits by Rs.7,011 million compared with preceding year.

2.2 Trend Analysis of major Income and Expenditure items

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

- a) Net Interest income had been increased by Rs.3,947 million 16 per cent in the year under review against previous year due to increase of interest income from loan and advances by Rs.8,192 million.
- b) Net Gain from Trading also increased by Rs.2,199 million or 310 per cent during the year 2019 due to gain received from fixed income securities and equity securities.
- c) According to the decrease of loss on revaluation of foreign exchange by Rs.765 million, net operating income has been decreased.
- d) Personnel expenses during the year under review had been increased by 10 per cent due to increase of salaries and bonuses.

2.3 Ratio Analysis

According to the information made available, certain important ratios of the Bank for the year under review and the preceding year are given below.

Description	Sector Ratio *	Bank	
		2019	2018
Profitability Ratios			
Return on Equity (ROE)	6.8	15.32	10.95
Return on Assets (ROA)	0.8	0.95	0.78
Interest Margin	3.4	2.63	2.43
Assets Quality Ratio			
Gross Nonperforming Advances (NPL)	5.5	1.57	1.44
Capital Adequacy Ratios			
Basel 111 – Tier 1 (Minimum 8.5%)	12.3	12.02	13.08
Basel 111 – Total (Minimum 12.5%)	15.6	14.35	15.90
Liquidity Assets Ratio	53.1	60.2	54.9

- a) Profitability of the bank in the year under review is at a favorable condition due to increase of Return on Equity (ROE) and Return on Assets (ROA) and Interest margin during the year under review compared with previous year.
- b) Gross non performing advance ratio has been increased by 0.13 per cent during the year under review. It is less than the sector ratio of 5.5.

- c) Bank has maintained Capital Adequacy Ratios (CAR) at above the minimum statutory limits of Tier-I capital ratio of 8.5 per cent and total capital ratio of 12.5 per cent during the year 2019.
- d) Liquidity asset ratio of the bank has increased from 54.9 per cent to 60 per cent during the year 2019.

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
<p>The bank had issued 1,955,432 number of ATM cards during the period of 2008-2019. Out of above, 1,575,802 number of cards or 81 per cent were Mag Stripe Cards and 379,630 numbers of cards or 19 per cent of cards were EMV Cards. All reported seventeen ATM skimming frauds had happened through Mag Stripe Cards. Total value of ATM Skimming Frauds as at 31 December 2019 was Rs.2,300,290.</p>	<p>Since May 2018 onwards Bank issues only EMV Cards to the customers. However, migration of existing Mag Strip Cards to EMV Cards could not be commenced from 2018 since required EMV card stocks were not available at that time. Further, the active debit card base of the Bank is around 800,000; even though the total number of issued debit cards were around 1.9 million and the Bank has issued more than 500,000 EMV cards during last two years.</p> <p>The Bank has procured EMV cards for migration of Mag Strip card to EMV cards, however, the process could not be commenced due to the lockdown of the country as a result of COVID - 19 pandemic. Further, migration of Mag Strip card to EMV cards requires significant effort and it is time consuming exercise which includes creating customer awareness through campaigns and operational effort through allocation of Branch staff without significant negative impact on routine operations in the Branches.</p> <p>However, the migration of Mag Strip debit cards to EMV debit cards would be commenced gradually from last quarter of 2020. And the old Mag Strip</p>	<p>Actions should be taken to issue EMV card for existing Mag Strip card holders to prevent ATM Skimming frauds in future.</p>

debit cards that have not been used for more than 5 years would be cancelled from last quarter of 2020.

- a. Out of the frauds value of above 17 cases ,7 cases reported in last two years had been lodged for insurance. Out of the remaining 10 cases, 9 cases amounting to Rs.784,383 could not be recovered from insurance.
- a. When there is a Card Skimming fraud on Mag Strip Cards, the issuing bank has to bear the loss as per the EMV Liability Shift Rules imposed by MasterCard and VISA. This fact is known to Insurance Companies and they also stop covering the losses incurred on MagStrip Card Skimming. Even though the Bank has made efforts to cover the losses of card skimming frauds on Mag Strip debit cards, insurance claims were not received mentioning that insurance would not cover the losses occurred by liability shifts and actions will be taken to write off the losses.
- b. High risk was observed for the customers who have higher balances in their savings accounts and use magnetic strip cards.
- b. Since the Bank has not commenced the migration exercise of old Mag Strip cards, the customers who are using old Mag Strip cards have not been analyzed in detail. However, actions were taken to issue EMV cards to customers identified in the list and new EMV cards have been issued to most of them. Further, it was noted most of those customers have obtained housing loans from the Bank and have used their old accounts with the Bank to keep the funds disbursed. During the planned Mag Strip migration process, the Bank will also follow the analyzing of customer accounts based on the savings account balances.

3.3 Operational Inefficiencies

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
<p>Out of 256 branches, 6 were identified as loss-making branches during the year under review. Out of them, Deiyandara, Pannala and Makola branches had opened during last two years. Akkareipattu branch had recorded a loss of Rs.726,418 compared with corresponding profit of Rs.839,230 in the last year. Potuvil and Udugama branches incurred losses of Rs.4,793,522 and Rs.2,330,347 respectively in 2019 compared with the profit of Rs.2,086,885 and Rs.7,075,672 in 2018.</p>	<p>The number of loss-making branches has been reduced from 13 reported in 2018 to 6 in 2019. Akkareipattu Branch has incurred losses mainly due to increase in Employee Emoluments by Rs. 2.4 Million (24%) and Administrative Expenses by Rs. 1.5 Million (32%).</p> <p>Loss of Rs. 2,086,885 reported in 2018 in Potuvil Branch has increased by Rs. 2,706,637.61 in 2019 mainly due to increase of Employee Emoluments by 45% and Administration expenses by 16%.</p> <p>The loss of Rs. 7,075,672 reported in Udugama Branch has reduced to Rs. 2,330,347.64 in 2019 mainly on account of increase in Interest Income received on Personal Loans by Rs. 9,702,421.54 as opposed to increase of Interest Expenses by Rs. 5,312,535.90.</p> <p>Generally, it takes about 03 years to make profit after opening a branch. Accordingly, Deiyandara, Pannala and Makola Branches have not exceeded this 03-year period. Potuvil Branch was relocated to another place in 2018 and the cost incurred for the same has caused for loss making of the Branch. The reason for the negative impact on the profit of Akkaraipattu Branch is the low volume of disbursement of loans comparing with the deposit volume of the Branch. In all</p>	<p>To maximize the branch's profit, the bank should minimize the branch employee emoluments by utilizing optimum staff.</p>

these Branches, in comparison to the previous years, there is a tendency of reduction in the cost, thereby defeating the prevailing unfavorable situation in the end of the year.

3.4 Transactions of Contentious Nature

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
<p>The Bank had incurred an amount of Rs.83.6 million for the construction of buildings in eight lands without being obtained the legal ownership of the lands. Such lands are situated in Anuradhapura, Elpitiya, Galnewa, Katharagama, Kiridiwela, Monaragala, Rathnapura. As per the valuation done in 2017 the value of the construction was Rs.97.14 million. Some of above lands had obtained by the Bank on lease basis without signing the lease agreement. Even though, some of lands had been acquired by the bank, no documentary evidence were not made available to audit.</p>	<p>Anuradhapura Divisional Secretariat has informed UDA and Anuradhapura Municipal Council to facilitate required documents in order to prepare the long-term lease.</p> <p>Elpitiya Bank has paid arrears rent of Rs. 5,610,000/= for the period of 2012 to 2018 to the Divisional Secretariat – Elpitiya. Survey Department has been informed by DS – Elpitiya to facilitate required documents pertaining to the long-term lease agreement of Elpitiya Branch.</p> <p>Galnewa Bank has issued a consent letter for entering into a long-term lease, as per the request made by the Divisional Secretariat.</p> <p>Kataragama The Bank has requested Ruhunu Kataragama Devalaya (The Owner) to enter into a long-term lease and 1st reminder has been sent.</p> <p>Kirindiwela Dompe Divisional Secretariat has informed to the Land</p>	<p>Bank should obtain leasehold right of lands by entering in to lease agreements before start the construction activities.</p>

Commissioner General's Department on preparation of the long-term lease.

Moneragala

Bank has paid Ground Rental pertaining to the year 2020 to the Divisional Secretariat and it is processing to enter into a long-term lease.

Ratnapura

Bank has paid arrears rent of Rs. 29,967,735/= for the period from 1975 to 2019 to the Divisional Secretariat and informed to prepare the long-term lease.

3.5 Idle or underutilized Property, Plant and Equipment

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
<p>The land with an extent of 38.8 perches was leased from the Urban Development Authority in the year 2008 for a 50-year period had not been properly used for last 11 years.</p>	<p>This land of 38.8 perch had been earlier identified by the UDA as an alternative land for re-settlement of the families living at the NSB adjoining land (106 perches) which is to be leased out from UDA on long term basis. Therefore, a permanent construction has not been done during this period. However, this land is being continuously used by the Bank as staff vehicle park. Since, the Government has decided to postpone the new construction projects in State Institutions, the land will be used for parking purposes until such time the restrictions are cleared.</p>	<p>Bank should effectively utilize bank's assets.</p>

3.6 Human Resources Management

Audit Issue	Management Comment	Recommendation
<p>Although the approved cadre of the Bank as at 31 December 2019 was 5,407, the actual cadre was 4,715 which consists of 4,319 permanent staff and 396 contract basis employees. Therefore, 692 posts are vacant at that date.</p>		
<p>(a) At the end of the year 2019, five Deputy General Managers, 2 Assistant General Managers, 23 Chief Managers, 7 Senior Managers, 6 Managers, 137 Assistant Managers and 16 Confidential Secretaries were included in the above vacant position. This may have an implication to smooth operation of the Bank.</p>	<p>a) A delay in filling of vacancies has been occurred until 3rd quarter of 2020 due to the General Election 2020 and postponement of General Election 2020 due to COVID 19 pandemic. Out of the 05 vacancies in DGM grade, 02 vacancies i.e. DGM (Finance) and DGM (R & D) occurred due to the promotion of the DGM to the post of Senior DGM. The remaining 03 vacancies occurred due to retirement of respective employees. Out of remaining 03 vacancies, DGM (HRD) and DGM (IT) are covered by the AGM. AGM (Retail Credit, Audit, Legal, Marketing) were vacant as at 31.12.2019 in the AGM category. However, since there were 2 excess positions in the post of AGM (Operations), the total vacancies in the AGM category remains as 02. Written examination conducted for promotion to Gr. III-II and III-III. Application called for promotion to Grade IV.</p>	<p>Bank should take actions to fill the vacancies on time for smooth operation of the bank</p>

Grade III-III interviews commenced. Further, the Bank is in the process of reviewing the Man-Power Plan for the year 2021. When reviewing it, the requirement of the branch sector and all the divisions are considered. Accordingly, arrangements will be made to fill the vacant positions by way of recruitment and internal promotions.

- (b) According to the paragraph no 9.2 (d) of the Public Enterprise circular PED 12, the organization chart and the approved cadre should be registered with the Department of Public Enterprise, General Treasury. However, bank had not complied with said circular.
- b) As the practice adopted by the Bank so far, the HRD Division prepares the Manpower Plan based on the Bank's Annual Budget. Only the Bank's Annual Budget is registered at the Department of Public Enterprises of the General Treasury. Bank should comply with PED circulars regarding carder management.