

Sri Lanka Deposit Insurance and Liquidity Support Scheme - 2021

1. Financial Statements

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 2021 comprising the statement of financial position as at 31 December 2021 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 financial statements of the Scheme give a true and fair view of the financial position as at 31 December 2021, 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

The operating result of the year under review amounted to a profit of Rs. 16.5 billion and the corresponding loss in the preceding year amounted to Rs. 11.3 billion. Therefore, an improvement amounting to Rs. 27.8 billion of the financial result was observed. The main reason for the improvement is the decrease of compensation payment made during the year under review.

3. Operational review

3.1 Member Institutions of the Scheme

Audit Observation

According to Section 4.1 of the Sri Lanka Deposit Insurance and Liquidity Support Scheme Regulations, No. 2 of 2021 dated 6 August 2021 and effective from the same date, every licensed bank and licensed finance company shall be a member of the Scheme. However, licensed micro finance companies which are engaged in micro finance business are not covered under these regulations. Therefore, licensed micro finance companies are not required to become the member institutions of the Scheme. Depositors of such institutions are not entitled to claim compensation when the license issued is cancelled by the Monetary Board. According to the information published by the Central Bank of Sri Lanka, four companies had been licensed as micro finance companies as at 30 June 2021.

Management Comment

In terms of the Microfinance Act Direction, No. 1 of 2019 dated 06 March 2019 on "Deposits", issued on 06th March 2019, every Licensed Microfinance Company (LMFC) shall accept deposits only as collateral deposits. Further, LMFCs shall always be in the position of a net lender, and the total deposits of a LMFC shall not be more than sixty percent of its total performing loans and advances. The direction further provides that if a customer of a LMFC has fully repaid the micro finance loan obtained from LMFC, such LMFC shall not hold the collateralized deposits for more than six months from such repayment date. Accordingly, in general, those 'depositors' of LMFCs are net borrowers. In these circumstances, the protection sought to be provided to the depositors of financial institutions cannot be equally extended to LMFCs. Hence the existing Regulations applicable to the Sri Lanka Deposit Insurance and Liquidity Support Scheme do not cover such category.

Recommendation

Need to consider the possibility of making LMFCs as members of the Scheme.

3.2 Loans to Member Institutions (MIs)

Audit Observation

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.1.47 billion. 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. An impairment provision of Rs.1,095 million had been made in the financial statements for the year ended 31.12.2021 in respect of this loan balance.

Management Comment

Not commented

Recommendation

To take appropriate actions to recover the outstanding loan balance.

3.3 Identified Losses

Audit Observation

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. Accordingly, an impairment allowance amounting to Rs.144.25 million for the above investment had been made in the financial statements of the Scheme on 31 December 2015.

Management Comment

Not commented

Recommendation

To take necessary actions to mitigate such risk in future.

3.4 Payment made out of the Fund

Audit Observation

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 six member institutions were cancelled/ suspended during the years of 2018, 2019 and 2020 by the Monetary Board. As per the Press release published by the Central Bank of Sri Lanka on 19.03.2021, the Monetary Board of the Central Bank of

Management Comment

Not commented

Recommendation

Complete the compensation payment to eligible depositors.

Sri Lanka had decided to increase the maximum compensation payment under the Scheme from Rs.600,000 to Rs.1,100,000 by Rs. 500,000 in order to provide further relief to the depositors of financial institutions regulated by Central Bank of Sri Lanka in the event of a cancellation or suspension of the licenses of such institutions. According to the information made available, total compensation payable to the depositors of six finance companies which licenses were cancelled / suspended by the Monetary Board, was Rs. 35,243 million and out of that, a sum of Rs. 29,242 million or 83 per cent had been paid out of the Scheme as at 31.12.2021.

3.5 Premium to be levied on insured deposits

Audit Observation

According to the Sri Lanka Deposit Insurance and Liquidity Support Scheme Regulations, No. 2 of 2021, licensed finance companies shall be payable premium of 0.15 per cent per annum, payable monthly calculated on the total amount of all eligible deposits as at end of the month. Sri Lanka Deposit Insurance and Liquidity Support Scheme Regulations, No. 1 of 2010 also contained similar percentage for finance companies. The total premium collected from six finance companies whose licenses were cancelled /suspended by the Monetary Board, was Rs. 845.6 million and total compensation payable was Rs. 35,243 million as at 31 December 2021. As the compensation payment had been increased to Rs. 1,100,000 in year 2021 from Rs 600,000 by the Monetary Board, it may be necessary reconsider the premium to be levied from the finance companies.

Management Comment

It is natural that in the case of an insurance scheme of this nature, the volume of compensation paid to depositors of a financial institution may be greater than the premium collected from the specific financial institution. The rate at which premia are collected from all member institutions is determined having regard to different facets of the issue, including the macroeconomic environment of the country. Accordingly, from time to time policy decisions are taken to determine the premium rates as well as the calculation methodology.

Recommendation

Need to consider implementing a risk based premium system.