

## **Pradeshiya Sanwardana Bank - 2021**

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### **1.1 Opinion**

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The audit of the financial statements of the Pradeshiya Sanwardana Bank (the “Bank”) for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 and the statement of profit or loss, 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(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. 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 Bank 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**

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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**

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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 determines 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 Bank’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 Bank or to cease operations, or has no realistic alternative but to do so.

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

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

### **1.4 Audit Scope**

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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 Bank'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 Bank'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 Bank 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

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
<p>I. Extensive manual process for the preparation of financial statements, requirement for a system driven solution for additional calculations arising due to adoption of SLFRS, entries posted directly to the financial statements without adjusting to the General Ledger, unavailability of updated manual for finance department, lack of formal documented policy over information used for financial reporting, were observed regarding the financial statement closure process of the bank.</p>	<p>Extensive manual process in preparing of financial statements is inevitable due to some limitations of Core Banking System (CBS). Adjusting entries are incorporated in the financial statements when necessary and subsequently posted to the General Ledger (GL) since facility of posting backdated entries to the GL is not available in the CBS. Even if an updated manual for finance department is not available, financial statement closure process is well documented and an updated document is distributed to all branches in December every year.</p>	<p>Take necessary actions to strengthen the internal controls relating to preparation of financial statements.</p>
<p>II. Unavailability of Central Liability Report, no review process in the Individual significant Loans working and further improvements needed in the impairment computation were observed. Considerable delay in submitting financial statements and making adjustments for the audit observations identified and errors in notes to the financial statements were noted due to not reviewing the submitted financial statements by separate division.</p>	<p>Proper review process through Internal Audit Department is in place and further improvements are being considered for the impairment computation. Some delays were experienced due to complexity of impairment calculations and unavoidable circumstances for the last year. Maximum effort would be made to avoid recurrence of such incidences in the future.</p>	
<p>III. Several general ledger accounts for the same description had been created by the bank leading to confusion in entering balances to the relevant ledger. Further,</p>	<p>This matter would be taken up with IT Department and necessary rectifications would be made accordingly.</p>	

minus balances were observed in relation to some income accounts.

## 1.5.2 Unreconciled records

Audit Issue	Management Comment	Recommendation
<p>I. Actions had not been taken by the bank to reconcile Interest in suspense-covid 19 and therefore, above account had been reconciled by crediting Rs.167,026,840 to creditors. Further, customer wise details of above balances were not available in the centralized level.</p>	<p>This amount represents suspended interest should have been recognized manually since corresponding interest receivable has been recovered in cash. This amount would be further verified and recognized as interest income by end of this year.</p>	<p>Take necessary actions to reconcile interest in suspense Covid 19 and related receivable accounts and refund any excess interest collected not adhering with CBSL Directions.</p>
<p>II. Differences amounting to Rs.10,090,829 have been observed related to the bank owned lands between the GL balances and note no.24(6) of the financial statements as at 31.12.2021 due to not classifying land and buildings accurately.</p>	<p>Necessary actions would be taken to rectify in future.</p>	<p>Take necessary actions to reconcile unreconciled records without further delay and prepare financial statements accurately.</p>
<p>III. Previous lease agreements of some branches had been ended during the year 2021 and new agreements had been signed as per the Right of Use assets computation. However, additions to the lease liability and Right of Use assets had not been recognized and impact had been adjusted under interest cost due to an error in formula.</p>	<p>This matter would be considered in future computations.</p>	
<p>IV. A credit balance of Rs. 20,581,415 had been observed in the Rent paid in advance account as at 31.12.2021.</p>	<p>This matter would be addressed in future computations.</p>	

- V. A difference of Rs.62,060,413 had been observed in the General Ledger balance and the loans master list prepared for impairment computation regarding the interest receivable of Loans against deposits. This matter had been taken up with IT Department and necessary rectification was made after pointed out by National Audit Office in final accounts of 2021.
- VI. Differences amounting to Rs.55,335,638 had been observed between the balances as per General Ledger and outstanding balances of deposit portfolio as at 31.12.2021. Now we are in the process of investigating the root causes of these differences. Once this is over, actions would be taken to rectify the same probably on or before 31.12.2022.

### 1.5.3. Documentary Evidences not made available for Audit

#### Audit Issue

Evidences were not available to verify the stock of Lankaputhra Development Bank amounting to Rs.11,106,023 and minus balance of Rs.952, 007 of stock in transit.

#### Management Comment

At the acquisition of Lankaputhra Development Bank (LDB), these balances were held in the books of accounts of LDB. However, at the point of acquisition a provision was made against stock anomalies. A part of stock was physically verified and the rest yet to be verified in due course. Further if any anomalies arise after verification, same will be written off by the provision held and process is planned to be completed by 31.12.2022.

#### Recommendation

Take necessary actions to check the accuracy of stocks value and make required adjustments without any further delay.

## 1.6 Accounts Receivable and Payable

### 1.6.1 Receivables

#### Audit Issue

I. Non Performing Loans outstanding amounting to Rs.1,132,412,322, interest of

#### Management Comment

Impairment computation has been done using the information which is generated through the core

#### Recommendation

Take necessary actions to grant and recover loans and advances in compliance with

Rs. 41,737,913 and charges of Rs. 691,673 had been recovered by granting new loan and without receiving cash from the customer during the year 2021. Accordingly, 13,321 number of loans amounting to Rs. 2,154,243,252 had been granted for settling above Non-Performing loans. Interest and other charges recovered from closed non-performing loans had been reversed for the financial statements of 2021 and adjustments had been made for the closed non-performing loans and performing closed loans during the November & December. However, under provision for impairment was observed due to improvement in past due days and higher Not Applicable facilities for Probability of Default computation with the closing of old loans and granting new loans without receiving cash inflow to the bank.

banking system. Manual changes have been done in the computation to rectify this matter up to a certain extent. However, actions would be taken to avoid such incidences in future.

Directions issued by the Central Bank of Sri Lanka and ensure the accuracy of prepared financial statements.

II. Loans categorized under stage 2 had been increased by Rs.9.8 billion or 42 percent compared with the stage 2 loans of year 2020 due to deteriorating of the quality of loans.

Quality of loans was deteriorated due to unprecedented and grave circumstances that prevail in the country due to the Covid 19 pandemic situation, staff shortages and country wide lockdown which prevented customer visiting the branches for servicing their loans in timely manner. This affected not only recovery of loans but also loan restructuring and moratorium processes. Further, customer base of Pradeshiya Sanwardana Bank is from rural, low and middle income families who were

Take necessary actions to reduce the non performing loans in line with the Directions issued by the Central Bank of Sri Lanka while increasing the quality of loan portfolio.

significantly affected due to the fertilizer issue, salary cut downs, loss of jobs etc.

III. Gross non- performing loans ratio of the bank had reduced to 8.71 percent as at 31.12.2021 from 10.11 percent as at 31.12.2020. However, non-performing loans balance had been reduced only by Rs.336.5 million as compared with the year ended 31.12.2020.

Non-performing ratio has been reduced due to increase of total loan portfolio by Rs.21.9billion when compared with the year 2020.

IV. Rs.117 billion or 61.9 percent of the gross loans as at 31.12.2021 had been granted on personal guarantee and therefore, recoverability of loan outstanding balances are questionable in the case of default.

Customer base of the Pradeshiya Sanwardana Bank is from low / middle income earners who are from rural areas and most of them either don't have valuable assets or assets owned cannot be taken as securities due to low value or legal barriers. Hence majority of loans have been granted on personal guarantees.

V. 325 number of loans amounting to Rs. 531,268,458 had been granted to the customers who were above age of 80 and outstanding balance of above loans as at 31.12.2021 was Rs.37,908,237. However, recoverability of these loans is questionable due to the reduction of earning income with the increase of age limit.

As a practice of the bank, loans are not granted for the customers who are above the age of 60 years unless loan insurance is available, or the age of joint borrower is less than 60 years as at the end of loan tenure. However, at the time of granting term loans on immovable property mortgages and the owner of the property is the co-borrower, age limit of the borrower is not seriously considered. Further, outstanding balance as at 31.12.2021 is not significant.

#### VI. Interest Rates

As per the Monetary policy review No. 03 of April 2022 dated 08.04.2022, monetary board of the Central Bank of

Since most of the loan facilities of the bank granted with fixed interest rates, there is a technical issue for the bank to adjust

Take necessary actions to effectively manage the loans and deposits portfolios.

Sri Lanka had decided to increase the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) to 13.5 per cent and 14.5 per cent respectively. 621995 number of loans with an outstanding balance of Rs.166,591,270,626 had been recorded as at 31.12.2021. Out of that, 423760 number of loans with an outstanding balance of Rs. 129,018,194,387 or 77 per cent from the total outstanding balance as at 31.12.2021 carries less than 15 per cent rate of interest. Therefore, negative impact may be recorded for the net interest income with the increasing trend of interest rates for fixed deposit more than 20 percent.

interest rates for already lent facilities in line with CBSL announced policy rates. However, bank has taken initiatives to adjust interest rates by 2-3 percent on certain fraction of existing portfolio with the approval of the board of directors which in turn would be a remedy to the raised concern.

VII. 294 number of loans with outstanding balance of Rs. 123,812,228 and interest outstanding balance of Rs. 14,433,266 had been maintained manually without entering to the system.

These loans had been granted by the former SME bank and customers of SME bank do not have savings accounts at Pradeshiya Sanwardana Bank or former Lankaputhra Development Bank. Therefore, they settle their loans by depositing money through other Commercial Bank accounts. Due to non-availability of Savings accounts for the customers of SME bank, it could not migrate the SME loans to the CBS System of Pradeshiya Sanwardana Bank. But for the reporting & recovery purpose, the detailed excel sheet has been maintained by including update balances of SME loans.

Take necessary actions to maintain all facilities through the system.

VIII. Interest Receivable for senior citizens amounting to Rs. 36,391,067 in relevant to the

Interest receivable from Ministry of Finance on Senior Citizen Deposits is being followed up

Take necessary actions to compute interest receivable balance of senior citizens



year 2020 and the amount of Rs.1,581,298,999 for 2021 had not been received from the General Treasury up to the date of 01.06.2022.

with respective ministry officials and bank would receive a substantial amount by the end of this year.

accurately and recover the receivable balances.

## 1.6.2 Payables

### Audit Issue

### Management Comment

### Recommendation

I. Loans granted for closed down garment factories by Lankaputhra Development Bank Rs. 750,000,000 had been received to the LDB for the disbursement among closed down garment factories as per the cabinet memorandum No. MF/FMAU/TAEL/CM dated 22.01.2007 where the Ministry of Finance is acting as the facilitator to implement a scheme to restructure/rehabilitate closed factories. Out of these funds Rs. 700,000,000 had been received with related to closed garment factory and Rs. 50,000,000 had been received for other 5 factories.

Take necessary actions to recover the loan outstanding balances and remit the collected money to the General Treasury.

(i) Out of the received amount of Rs. 700,000,000 for closed garment factory, LDB had disbursed only Rs. 580,865,369 and therefore, Rs. 119,134,631 had been available with the bank without reimbursing to the treasury. Further, contrary to the section 7 of the above Cabinet memorandum, Rs.5,500,000 had been retained by the LDB out of the total collection of Rs. 25,500,000 from closed

Out of the received amount of Rs. 700 million meant for closed garment factory, former LDB had disbursed Rs. 580.8 million only and the balance represented trade finance facility made available through government bank for which there was not any cash flow involvement unless facility was utilized. Hence, unutilized amount of Rs. 119.1 million was accounted as a liability to Ministry of Finance. Further, a collected sum of Rs. 5.5 million from above garment factory was not remitted to Ministry in view

garment factory without reimbursing to the treasury. of insignificance of the amount and accounted as a liability to the Ministry.

- (ii) Out of the received amount of Rs. 50,000,000 for other factories, Rs.49,000,000 facilities were approved. However, only Rs.25,354,517 had been disbursed to the companies as per the customer loan statements from the LDB. Contrary to the section 7 of the above Cabinet memorandum, the bank had retained collected money from other factories of Rs.16,000,482 without reimbursing to the treasury. Out of received amount of Rs. 50 million for other factories, former LDB had planned to disburse Rs. 49 million. However, only Rs. 25.3 million was granted since some factories had not complied with eligibility criteria. Bank has collected Rs. 16 million from some factories through litigation and accounted in the books as a liability to Ministry of Finance.

## II. Credit Guarantee Indemnity

Rs. 17,364,550 had been shown under Credit guarantee indemnity balance as at 31.12.2021 under other liabilities in the financial statements. However, evidences were not available to confirm the above balance and out of the above, Rs. 15,148,819 have been remained same for 3 years or more. Further, debit balances were also remained in the above account as at 31.12.2021. This amount represents the claim received from Central Bank of Sri Lanka on NCRCS loan facilities. This amount shown in the general ledger as a liability since bank failed to comply with certain conditions and the said amount repayable to CBSL back. However this amount would be further verified and necessary actions be taken accordingly towards end of this year.

Take necessary actions to settle long outstanding payable balances without any further delay and reconcile any differences.

## III. Rs. 13,551,546 had been remained from the year 2020 as “transferring SME settlement account balances” to RDB accounts.

This amount reflects the amounts collected from customers of former SME Bank over and above the due amounts as per the loan module used by the bank. As the customers do not maintain savings accounts with then SME bank, this account has been created to temporarily park the deposits made by the customers

Take necessary actions to reconcile the balances and remit to the customers excess amount recovered if any.

on account of loans. Hence, composition of these accounts would be further examined and initiatives would be taken to recognize in to income towards end of this year.

- IV. As per the loan settlement status report as at 31.07. 2020 from Time Account System of SME bank, credit balances of Rs. 4,145,335 had been remained for fully settled loans.
- These loans were maintained in the DMS system which was used by SME Bank. However, after completion of period of loans interest calculation for same are stopped due to a system limitation. Hence, after completion the period of loan interest has been calculated manually. Accordingly, these loans were settled without debiting the interest for some period after the end of tenor. Hence it was observed these credit balances has to be taken in to the income account after the verification.
- Take necessary actions to reconcile the balances and remit to the customers excess amount recovered if any.
- V. Refinance loans
- Loan schemes/revolving funds balances amounting to Rs.118,293,138 have been remained without settling for a long period.
- These balances have been identified in general ledger for a long period of time and therefore, bank wishes to implement a new loan scheme consolidating above funds accumulated in compliance with laws and regulations and discussions with the related organizations.
- Take necessary actions to settle the payables or act as per the agreements.
- VI. Total additional provisioning
- (i) As per the letter no. PE/BN/RDB/Gen/2019 dated 10.01.2019 issued by the Director General Department of Public Enterprises, approval of the Secretary to the Treasury has been granted to go ahead with the acquisition /merger of
- Since there are some unresolved tax matters with Department of Inland Revenue, pending litigation and non-existing current assets taken over from former Lankaputhra Development Bank the outcome of which cannot be ascertained at this juncture, bank has to continue with this provision further. However, we
- Take necessary actions to act as per the approval conditions of acquisition/ merger of Lankaputhra Development Bank.

the LDB with the RDB, expect to resolve most of the subject to adjusting the issues underlying with this potential tax liability by provision towards end of this the amount which has year. already been settled by the LDB and any further upward revisions depend on the future circumstances. However, merger control account of LDB had been cleared on 11.02.2021 by transferring Rs.398,928,000 to the contingency provision without assessing the reasonableness.

- (ii) Further, Rs.76,740,121 had been transferred to the retained earnings without assessing the requirement of issuing shares to General treasury.
- Purchase consideration for the acquisition of former Lankaputhra Development Bank was computed based on financial statement as at 30 November 2018 on which the acquisition was made. Hence, post - acquisition profits of former LDB until merger taken place amounting to Rs. 76,740,121 was recognized as part of retained profits of PSB since said amount was not due to Ministry of Finance.
- Shares had been issued with the effective date of 31.12.2018 based on the financial statements of LDB as at 30.11.2018. However, activities of LDB had been continued up to 31.03.2019 and the merger was taken place from 01.04.2019 and accordingly, shares need to be issued in favour of general treasury for the earnings of LDB during that period.

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

Reference to Laws, Rules and Regulations etc	Non compliance	Management Comment	Recommendation
I. Procurement Guideline reference 2.1.1 and Public Finance circular PF/429 (i)	Own developed procurement manual had been used by the bank without obtaining approvals from Director General	Entity specific procurement guideline which was used by RDB was forwarded to the Secretary of Ministry of Finance and same has been forwarded to the National	Take necessary actions to adhere with the cited direction.

of Public Finance. Procurement Commission (NPC) on 14.02.2017 by Ministry of Finance for the approval. As no response was received from the NPC the procurement guideline was again forwarded to the Director General of Public Finance on 10.03.2022. However, no response was received from Director General Public Finance as at to date.

- II. Section 4(8) of the Banking Act Direction No 4 of 2008 Bank shall not grant new credit facilities for repayment of NPL in the name of the same borrower, unless the credit facility so created is also classified as NPL and categorized into the same category of the repaid NPL had been categorized under direction 4(6). However, bank had classified rescheduled capital and interest accounts in the performing (A0) category contrary to the above direction.
- The bank has issued a circular guideline No:05/2022 dated 19.09.2022 with proper guidance in order to identify the credit facilities in accordance with CBSL banking directions No 13 of 2021. Therefore, this issue may not take place in future.
- Take necessary actions to adhere with the cited direction.

<p>III. Section 6.6 of the operational manual for state owned enterprises</p>	<p>Draft annual report and accounts had not been submitted to the Auditor General within 60 days after the closing of financial year.</p>	<p>In view of large volume of work in relation to impairment computation on individually significant loans and advances that has to be attended by branch officials, unexpected delay in finalizing draft accounts was experienced. Further, preparation of draft annual report was also delayed unexpectedly due to delay in finalizing due reports which are essential to be incorporated in the draft annual report.</p>	<p>Take necessary actions to adhere with the cited direction.</p>
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### 1.8 Non -compliance with Tax Regulations

<b>Audit Issue</b> -----	<b>Management Comment</b> -----	<b>Recommendation</b> -----
<p>I. PAYE tax /APIT Every Employer is required to deduct income tax from the gains and profits from employment of each employee who is liable to pay income tax with his consent. Contrary to Public Enterprises Circular No.PED 03/2016 of 29 April 2016, the Bank had paid APIT tax amounting to Rs. 15,325,245 for the year 2021 out of its own funds on behalf of its employees instead of being deducted from the salaries of the respective employees.</p>	<p>Before merging in to one entity in 2010 permanent employees in the six provincial banks had been enjoying the benefit of bearing the PAYE tax component by the employer. Further, Section 45 (2) (d) of Pradeshiya Sanwardana Bank Act No. 41 of 2008 states offering of employment on terms and conditions not less favorable than the terms and conditions which were previously enjoyed by them with the acquiring bank. On this basis RDB has been continuing bearing of PAYE tax liability of employees as an expense of the Bank. In addition, under the provisions of collective agreement with Ceylon Bank Employees' Union, the bank has been paying PAYE / APIT as the case may be of the employees like other state own banks, following the same practice and this is not a prohibited practice by the Inland Revenue Act.</p>	<p>Take necessary actions to adhere with the cited directions and pay taxes accordingly.</p>

## II. Income Tax

- (i) Rs.54,420,291 had been debited to the income tax expense account as an under provision to the previous year. However, any reason for the above accounting treatment was not available to the audit. This amount was recognized as an additional tax charge in relation to former Lankaputhra Development Bank and accounting treatment was done accordingly. However, further verifications in this regard are carried out at present.
- (ii) A difference of Rs.6,197,961 had been observed in the cost of disposals as at 31.12.2021 between the Property Plant & Equipment note and the income tax computation. This will be taken up with the tax consultants and necessary rectifications would be made in the tax computation if necessary towards filing of tax returns by end of November this year.

## 2. Financial Review

### 2.1. Financial Result

The operating result of the year under review amounted to a profit of Rs.775,504,600 and the corresponding profit in the preceding year amounted to Rs. 1,013,448,401. Therefore, a deterioration amounting to Rs. 237,943,801 or 23.5 percent of the financial result was observed. The main reasons for the deterioration are increase of impairment charges and increase of personnel expenses.

### 2.2. Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review compared with the preceding year is as follows.

Description	Variance Increase/ (Decrease) (Rs. Million)	Variance Percentage	Reason for the Variance
Interest Income on loans and advances	807	4.2	Increase of Gross Loans by 13 percent
Interest expense on customer deposits	2,465	22.5	Decrease of interest rates
Impairment charges	1,245.8	61.95	Decrease in the quality of loan portfolio and current economic conditions of the country

## 2.3. Ratio Analysis

Some of the important ratios of the bank for the year under review and the preceding year together with the sector ratios are as follows.

	<b>Sector Ratios (Licensed Specialized Banks)</b>	<b>2021</b>	<b>2020</b>
	----- Percentage	----- Percentage	----- Percentage
<b><u>Profitability Ratios</u></b>			
Net Profit Ratio (PAT)	13.9	1.25	1.66
Net Interest Margin	4.57	6.08	5.39
Net Interest Income on Interest Income	44.83	57.98	46.97
Non-Interest Income to Total Income	2.55	3.87	4.81
Interest Cost to Interest Income	55.17	42.02	53.03
Staff Cost to Operating Expenses	55.68	80.1	77.54
Return on Average Assets (PAT)	1.33	0.13	0.19
Return on Equity	21.54	1.99	2.67
Earnings Per Share		0.56	0.74
<b><u>Asset Quality</u></b>			
Non Performing Advance Ratio	6.47	8.71	10.11
<b><u>Capital Adequacy Ratios</u></b>			
	<b>Minimum Requirement</b>		
Common Equity Tier I Capital Ratio	7.5	8.72	10.34
Total Tier I Capital Ratio	8.5	8.72	10.34
Total Capital Ratio	12.5	14.27	14.94
<b><u>Liquidity Ratios</u></b>			
Statutory Liquidity Assets Ratio	20	26.18	29.3

## 3. Operational Review

### 3.1. Management Inefficiencies

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
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I. Disposal of Vehicles		Take necessary actions to utilize funds of the bank effectively and efficiently.
(i) Significant differences between the assessed minimum disposal value and the bid values were observed. Therefore, it is questionable the credibility of the estimation process and the professionalism of the people	Valuation of Motor vehicles was carried out by four member committee out of them two members were external professionals. Further, as considerable period has been taken after valuation to sell the	



involved in the estimation of minimum disposal value of 13 vehicles. vehicles, and due to the suspension of importing motor vehicles the prices of used vehicles in Sri Lanka has been increased significantly during that period.

- (ii) Since the demand for existing motor vehicles in the market is increasing due to the restriction on importing motor vehicles it is questionable whether the highest bid is a reasonable valuation for the vehicle. Vehicles have been sold for a significantly high value than the estimated value due to restriction on importing motor vehicles. However, vehicles were sold by a transparent process of public tender.

### 3.2. Transactions of Contentious Nature

#### Audit Issue

#### Management Comment

#### Recommendation

Cultivation loan of Rs. 900,000 had been granted by the Hambanthota Branch to a customer on 23.11.2013 with two personal guarantees.

This incident is being investigated by the Investigating Unit of PSB and primary investigation has been carried out and an investigation report has been submitted to the Bank's Employee Committee. The committee has recommended to obtain statements from relevant employee and statements received from employee were again submitted to the employee committee. By reviewing statements it was decided to issue charge sheets and statements received in response to charge sheets are to be submitted to the employee committee at present.

Take necessary actions against responsible parties and recover any dues to the bank. Further, actions should be taken to strengthen the internal control of the bank.

- (i) Guarantors signed for another loan and submitted salary slips of August and September 2017 for that loan had been used for this loan by the branch without informing to guarantors. Above loan had been granted for banana cultivation and the cost estimate had been prepared on the basis of cultivating 5 acres. However, actual size of the land was 2 acres 2 roods as per the grant letter, and therefore, the accuracy of the estimate was questionable. As per the letter of grant though the land was located in Tissamaharama, actually it was located in Hambantota as per the loan requirement inspection report. Further, any confirmation regarding the customer's right to cultivation had not been available with the bank.

(ii) Above loan had been granted on 16 percent rate of interest as per the Finance Circular No. 2015/30 (Loan Interest Rates). However, it had been computerized by the second officer of the branch and interest rate had been computerized as 12 percent instead of 16 percent. Further, 6-month period of moratorium had been given for this loan by the bank.

(iii) It was confirmed from the written statements of the bank officials that contrary to the internal control of the loan, second officer working in the branch had directly intervened to this loan from preparing loan application to approving and computerizing it. Above loan had been recommended by the branch manager and approved by the District Credit Committee and financial loss of Rs. 101,151 had been incurred to the bank due to interest rate difference in the system.

### 3.3. Human Resources Management

#### Audit Issue

#### Management Comment

#### Recommendation

##### I. Salary and non-salary benefits

(i) Basic salaries of employees of the bank had been increased ranging from 243 percent to 639 percent as at 31.12.2021 as compared with year 2011. Basic salary had been increased ranging from 13 percent to 57 percent with 2012-2014 collective agreement, 54 percent to 126 percent with the 2015-2017 collective agreement, 50 percent to 66 percent with the

Salary revision had been done by matching to salary scale of other state Banks. Compared to other state Banks of Sri Lanka, salary scales of PSB were in a very low level during the given time-period. The Bank and Union had entered into Collective Agreements during last 10 years to equalize the salary scales with other

Take necessary actions to effectively use the bank funds while increasing the efficiency of employees.

2018-2020 collective agreement and 26 percent to 33 percent in 2021. state Banks. As a result of equalization of salary scales, such salary increasing percentage has been shown.

- (ii) Approval from the board had been received for the gross salary incremental rates of both special grades and other staff categories included in the collective agreement. However, increase rate of basic salary is higher than the approved gross salary rate of employees due to adjusting the cost of living allowance. Salary increase has been made in compliance with the collective agreement entered into between management and unions. Accordingly, salaries were increased in compliance with gross salary incremental rate agreed upon. Hence, basic salary is increased in a higher rate than the agreed gross salary rate.
- (iii) Salary revisions of other banks had been considered in deciding the salary revision of RDB. However, applied salary revisions of those banks cannot be compared directly with RDB since the asset base, profit levels, number of employees and number of branches are not similar. Pradeshiya Sanwardana Bank is not a Commercial Bank. But a Specialized Bank whose customer base is different from most of the Commercial Banks. When comparing the branch network, PSB places in third. The Bank has been set up with the objective of improving the living standards of the rural masses by providing them accessible and affordable credit facilities that in turn would contribute to strengthen the rural economy. Originally PSB is based on the "barefoot banking concept". Even though loan amount per employee is low, No. of loans per employee will be very much similar or higher than the other Bank. Hence, comparing only with asset base, profit levels etc. are not practical.
- (iv) Though the bank had incurred Rs.2.82 million cost per employee per year, the profit generated per employee was only Rs.0.12 Unlike the customer base of other Banks, the customer base of PSB is from rural, low-income families who were

million for the year 2021.

significantly affected due to these economic conditions. Therefore, PSB is empowering its' customers in the micro, small and medium scale industries by providing affordable level of credit facilities. Due to the Covid - 19 pandemic and prevailing situation of the country, forgo the interest income of the loan portfolio, interest income of the Bank significantly reduced. Hence, profit per employee was also decreased.

- (v) Personnel expenses as a percentage of net operating income of the bank was 66 per cent for the year 2021 and represented highest value among other banks. Net operating income was drastically decreased due to the reasons stated above (iv). Hence, Personnel expenses as a percentage of net operating income of the bank was also increased.

## **II. Acting General Manager served during the year 2021**

- (i) As per the CBSL Direction No.09 of 2019 dated 19.12.2019 a Director or CEO shall not be appointed as a Director or a CEO of another Licensed Bank operating in Sri Lanka prior to expiry of 6 months cooling off period from the date of cessation of his/her office at a Licensed Bank. However, as per the letter No. MF1/BOD/PSB dated 26.10.2020 issued by secretary to the Ministry of Finance, Director of Treasury Operations Department had been appointed as acting General Manager of the bank contrary to the above. As per the letter No. MF1/BOD/PSB dated 26.10.2020 issued by secretary to the Ministry of Finance, Director of Treasury Operations Department had been appointed as acting General Manger to the Bank. This appointment had been done beyond Bank control.

Take necessary actions to adhere with the established directions and circulars in future.

- (ii) As per the Banking Act Determination No.01 of 2019 dated 19.12.2019 issued by CBSL, CEO and such other officers performing executive functions of licensed banks shall be fit and proper persons. However, Acting General Manager's fitness & propriety had not been submitted to CBSL. Further, above Acting General Manager's appointment is contradictory with the Section 26 of the Pradeshiya Sanwardana Bank Act No.41 of 2008.
- As per the letter No. MF1/BOD/PSB dated 26.10.2020 issued by secretary to the Ministry of Finance, Director of Treasury Operations Department had been appointed as acting General Manger to the Bank. This appointment had been done beyond Bank control.

### **III. Appointment of General Manager in 2022**

Following observations are made regarding the marks given for the GM interview held on 28.01.2022.

- (i) As per the PSB Act, minimum qualification for the above post was a degree from recognized university with postgraduate qualification **or** professional qualification in banking or any other relevant field. Therefore, degree from recognized university with postgraduate qualification is equivalent to professional qualification and as such bank should have considered the professional qualification as entry requirement for the candidates who have both qualifications since equal marks had not been allocated for equivalent qualifications. Same practice had been applied for the interview held on appointing General Manager on 02.10.2019 and professional qualification had been considered as entry requirement for the candidates who have
- In the approved marking scheme, it has been clearly mentioned that marks are given over and above minimum qualifications and no allocation has been done for basic/ entry requirements. If candidate has qualified with section 26(1)(a) as per the Pradeshiya Sanwardana Bank Act No. 41 of 2008, it cannot be considered twice.

Take necessary actions to correct the errors identified in the marks given in the interview. Further, every step should be taken to recruit/promote most suitable person in line with the issued circulars and guidelines considering the competencies of applicants and maintain the transparency in the process of recruitments and promotions.

both qualifications. However, 4 marks and 3 marks had not been given by the bank for other 2 candidates considering their basic qualification as professional qualification.

- (ii) As per the decision to the board paper No.2022/2927 dated 12.01.2022, the board had decided to remove the negative marks for age and to apply the previous marking scheme which was used at the last interview. Additional 2 marks or 3 marks respectively had been given for the associate membership or fellow membership of candidates during the previous interview held in 2019. However, bank had not given such marks during this interview.
- The marking scheme has been amended in the following instances.
- (i) Removing the negative marks for the age – (Board approval granted on 06.01.2022)
- (ii) Defining the Senior Management level as Assistant General Manager and above experience (Board approval granted on 23.09.2021)
- (iii) According to the marking scheme, a candidate who has passed the degree with a class will get an additional 1 mark. However, such additional 1 mark was not given to the candidates who had obtained the degree with a class.
- Other than the above amendments Board has practiced the same marking scheme, approved by the Board of Directors at its' meeting held on 06.09.2019
- (iv) Above interview had been conducted by 6 directors including the chairman and Secretary of State Ministry of Samurdhi. Some directors had given same marks for all 3 candidates and other directors had given closer to maximum marks for 1 candidate. Further, it was observed that marks given in the interview for some candidates are questionable with the submitted information relating to subject knowledge of
- The interview panel was comprising with Secretary State Ministry of Samurdhi , Household Economy, Micro Finance, Self employment and Business Development and 06 Board of Directors of PSB including chairman. The marks have been given independently in a rational manner.

their applications. One director had given 18 marks for the subject knowledge of selected candidate. However, details relating to experience of IT, finance & marketing were not available in the submitted application and therefore, it is questionable of giving 18 marks out of 20 for the subject knowledge.

#### **4. Accountability and Good Governance**

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##### **4.1. Corporate Plan**

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<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
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Board approved Corporate Plan for the year 2021 was not available and board approved Corporate Plan which is prepared for 2022-2024 is in place.	Preparation of corporate plan was started at the beginning of the year 2021. Due Covid- 19 pandemic and the situation prevailed at that time in the country this process was continued till year end.	Take necessary actions to prepare strategic plans promptly and achieve the targets as specified in the plans.