

Central Bank of Sri Lanka - 2011

1. Financial Statements

1.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Central Bank of Sri Lanka as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

1.2 Comments on Financial Statements

1.2.1 Accounting Deficiencies

The following observations are made.

- (a) The CBSL had acquired a property in New York, USA and rented out this building to the Permanent Mission of Sri Lanka to the UN at market rates until CBSL requires this building for its own use in the future. Although the ownership had been transferred on 30 August 2011, as per the CBSL records the purchase cost had been shown under the construction in progress account instead of being capitalized as at the end of the year under review.
- (b) The CBSL has constructed a building in Somawathi National Park in Polonnaruwa District. Even though the constructions were completed as at the end of the year under review, the property was shown under the Capital work-in-progress account instead of applying the correct accounting treatment.
- (c) The National Mutual Assurance Building was acquired by the CBSL for Rs.175 million on 22 December 2009. Instead of accounting under the Property Plant and Equipment or the Investment Property, it was shown as an advance in the financial statements as at the end of the year under review.
- (d) It was revealed in audit that 1811 items of engineering stock and 35 items of building material had not been valued and taken in to the stock balance shown in the financial statements for the year 2011 and as such the accuracy of the stock balance shown in the balance sheet could not be satisfied in audit.

1.2.2 Accounts Receivable and Payable

The following observations are made.

- (a) Undisbursed staff emoluments balance totalling Rs.688,117 had remained for over 03 years without taking any action to settle the balances or to credit to the income of the CBSL.
- (b) It was observed that the refundable tender deposit balance amounting to Rs. 2,147,547 had remained for over 05 years in a control account. However this balance had neither been claimed by the suppliers nor transferred to the income account by the CBSL up to the end of the year under review.

2. Financial and Operating Review

2.1 Financial Results

According to the financial statements presented, the operations of the CBSL for the year under review had resulted in net profit of Rs. 46,830 million as compared with the net profit of Rs. 11,743 million in the preceding year. The net foreign exchange revaluation gain of Rs.3,577 million as against the loss of Rs.8,659 million in the preceding year and the net income from local currency financial asset of Rs.226 million as compared with the net loss of Rs.4,219 million in the preceding year had been the reason for the increase in profit for the year under review.

2.2 Activities on Financial System Stability in Sri Lanka

2.2.1 Actions taken against the unauthorized financing businesses

The following observations are made in this regard.

- (a) Section 37 of the Finance Companies Act. No.78 of 1988 empowers the Monetary Board to take following actions against the persons carrying on business without authority. In the case of a company or an incorporated body of person, the name of that company incorporated body and name of the directors and in the case of a person or unincorporated body of persons, the name of such person or member of such incorporated body can be published as unauthorized finance business. Accordingly the Monetary Board had directed against a company which undertaken Unauthorized Financial Business, detected by the Supervision of Non – Banking Financial Institutions to take following actions on 21 February 2011;

- (i) not to accept any further deposits /grant new loans or make any investment with immediate effect
- (ii) to repay the deposit liabilities within 18 months and submit the confirmation with a monthly deposit repayment plan within one month
- (iii) submit a confirmation from an independent auditor about the deposit settlement
- (iv) change the External Auditors and appoint one of the three suggested audit firms.
- (v) cap their total deposits liabilities at the amount of deposit liabilities as at the date of the direction
- (vi) not to grant further facilities to the companies and related parties of the group and
- (vii) to recover the facilities already granted to the companies and related parties of the group in full within 03 months from the date of direction

Further, the Director- SNBFI (Supervision of Non – Banking Financial Institutions) had directed to publish the name and registered address of the company as an institution doing financial business in contravention of the provisions of the Finance Companies Act in the newspapers and initiate legal action against the company. Nevertheless it was revealed in audit that, the SNBFI had not taken further action against the said company even though the company had not complied with the directions issued by the Monetary Board up to the date of the audit. However CBSL had explained that the company was still under supervisory process for implementing the resolution actions given by the Monetary Board and the progress was satisfactory and therefore the publication of the name and initiating legal action were not necessary at this stage.

2.2.2 Supervision on Failed Finance Companies

The CBSL had granted direct loans and refinance facilities to 13 defaulted finance companies during the period 1988-1994 out of which two companies were rehabilitated and six companies have already been wound up and the balance five companies are now being in the liquidation process. The total outstanding balance as at 28 February 2011 consists of the capital of Rs.1, 936,494,749 and the interest of Rs. 4,217,766,345. The following observation is made in this regard.

- (a) The Monetary Board had granted approval to write off the total outstanding amounting to Rs.6,154,261,095 from the CBSL accounts and the Monetary Board was of the view that because the CBSL had made all attempts to recover the outstanding dues under

liquidation process, it was prudent to write off these balances for the fair presentation of financial statement. Further the Monetary Board had decided on 21 March 2011, that the claims submitted to the liquidators' remained valid and all attempt would have been taken to recover the dues from the liquidator.

However, subsequent to the above decision, the Monetary Board had decided on 01 September 2011 to claim from liquidation proceeds from six failed finance companies remained inactive until when the distribution was made by the liquidators. When considering the above decisions it was observed in audit that the Monetary Board had taken two contradictory decisions within the period of six months and the prudence of the reversal of previous decision was questionable in audit.

2.3 Regional Development Activities

The Regional Development Department (RDD) of the CBSL maintains 20 Revolving Funds and Credit Schemes to provide financing facilities to various regional development sectors through Participating Credit Institutions (PCIs). It was observed that even though the Regional Development Department (RDD) of the CBSL maintains 20 Revolving Funds and Credit Schemes during the year 2011, no clear fund disbursement targets had been identified for the individual revolving funds and instead disbursement targets have been fixed for the two broad categories of end- users for monitoring purposes, thus indicating a lack of control over the operations of the funds.

2.4 Human Resources Management

The Distress Relief Fund (EPDRF) of the Central Bank of Sri Lanka had been established for the purpose of granting financial assistance to the employees and the pensioners of the CBSL who are members of the Fund and facing financial difficulties due to sudden terminal illness, major surgeries and prolonged illness. As at the end of the year 2011, membership of the fund consisted of 844 employees in service and 874 pensioners and total contribution of the fund was Rs.36.3 Million. CBSL had explained that as per the Monetary Board decision, the fund should not be utilized until the fund it reaches an amount of Rs.100 million and as such the primary objectives of the fund had not been achieved until such time . Therefore the CBSL should needs to consider the regulatory changes to grant benefits to its members. Following observations are also made in this regard.

- (i) The fund had not been utilized for the intended purposes since its inception and instead it was invested in Government Securities.
- (ii) The Monetary Board had taken a decision on 15 February 2010 to release one Deputy Director in the Regional Development Department to a Foreign Funded

project established in the CBSL. Even though as per the paragraph 7 of section B of the loan agreement, borrower (Government of Sri Lanka) should provide a counterpart fund to cover the cost of staff seconded by the CBSL. However cost amounting to Rs.1, 938,870 incurred for the year 2011 had not been recovered from the counterpart fund up to the date of this report.

2.5 Contract Administration

A circuit bungalow had been constructed by the CBSL in the Somawathi National Park in Polonnaruwa District in the year 2010 and spent a sum of Rs.59.8 million for the construction work. Due to the provisions in the Wild Life Conservation Act, the legal ownership of the building had not been transferred to the CBSL. Instead CBSL had entered into a memorandum of understanding with the Department of Wild Life Conservation for the utilization of land for 30 years. However as per the records maintained by the Facilities Management Department of the CBSL, the bungalow had been occupied only in 13 occasions during the year under review and earned only Rs.71,500 as occupancy charges.

2.6 Matters of Contentious Nature

The following observations are made.

- (a) The CBSL had invested Greek Government Bonds in 05 April 2011 which had a face value of EUR 30,000,000 and a market value of EUR 22,163,500 when the economic recession prevailed in the country and the rating was downgraded by the rating agencies. Subsequently on 18 July 2011 and on 23 November 2011 the CBSL had sold EUR 5 million and EUR 10 million bonds respectively and incurred a loss of EUR 4,911,000. With regard to the balance of EUR 15 million, the CBSL had entered into a restructuring program on 12 March 2012. However the CBSL had sold all the restructured instruments up to 12 September 2012, and incurred a loss of US\$ 15.6 million from the entire transaction. However it was also observed that the CBSL had managed to earn a total profit of US\$ 430 million (excluding marked-to-market gain) or a rate of return of 6.6 per cent on the reserve portfolio in the year 2011.
- (b) The Monetary Board of the CBSL had granted approval on 10 January 2011, to purchase office buildings in Selected International Cities. As such the CBSL had remitted US\$ 5,807,116 to the Permanent Mission of Sri Lanka to the UN to purchase an Office Premises in New York. In this regard following observations are made.

- i. Although the intention of the procurement was for the use of the CBSL for its operations in future, as an interim measure, this premises had been rented out to the Permanent Mission of Sri Lanka to the UN which may contradict with Section 117 of the Monetary Law Act which states as “Central Bank Shall not engage in trade or otherwise have a direct interest in any Commercial, Industrial or other undertaking except such interest as it may in any way acquire in the course of the satisfaction of any of its claims”
- ii. The CBSL had sent US\$ 400,000 to the Permanent Mission of Sri Lanka to the UN to carry out the refurbishment work of the building. However the information regarding the process of contractor selection, originals of the supporting documents for the contractor’s payments (work certifications, progress bills) were not made available for audit.
- iii. Although the rental agreement had been signed with the Foreign Ministry on 28 May 2012, rental proceeds were received only for the Month of June 2012. However the CBSL had not taken any effective action to collect the outstanding rentals from the tenant up to the date of the audit.