

## **National Savings Bank - 2013**

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The audit of financial statements of the National Savings Bank (“the Bank”), and the consolidated financial statements of the Bank, and its Subsidiary for the year ended 31 December 2013, Comprising the statements of financial position as at 31 December 2013 and the statements of comprehensive income, Statements of changes in equity and cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory information, 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 Section 13(1) of the Finance Act, No. 38 of 1971. My comments and observations which I consider should be published with the annual report of the Bank in terms of Section 14(2) (c) of the Finance Act appear in this report. I was assisted by 15 firms of Chartered Accountants in public practice to audit of 15 Branches of the Bank. The financial statements of the Subsidiary were audited by a firm of Chartered Accountants in public practice appointed by the Board of Directors of the Subsidiary. A detailed report in terms of Section 13 (7) (a) of the Finance Act was issued to the Chairperson of the National Savings Bank on 09 October 2014.

### **1.2 Management’s Responsibility for the Financial Statements**

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Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

### **1.3 Auditor’s Responsibility**

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My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Standards of Supreme Audit Institutions (ISSAI 1000 -1810). Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **2. Financial Statements**

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### **2.1 Opinion - Bank**

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In my opinion , the financial statements give a true and fair view of the financial position of the National Savings Bank as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### **Opinion - Group**

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In my opinion, the consolidated financial statements give a true and fair view of the financial position of the National Savings Bank and its subsidiary as at 31 December 2013 and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

## **2.2 Comments on Financial Statements**

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### **2.2.1 Group Financial Statements**

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The audited financial statements of the National Savings Bank Fund Management Company Ltd, which is fully owned subsidiary of the Bank, had been taken for the preparation of the consolidated financial statements.

### **2.2.2 Accounts Receivable and Payable**

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The following observations are made.

- (a) Out of a sum of Rs. 659,014,723 receivable from the General Treasury on dormant accounts, an amounting to Rs. 281,079,089 had remained outstanding for over five years.
- (b) The fraudulent withdrawals as at 31 December 2013 amounted to Rs. 23,193,414, out of that Rs. 12,435,981 was remained outstanding for more than one year.
- (c) Refundable tender deposits to customers amounting to Rs. 3,583,416 representing 42 per cent of the total outstanding had remained none refunded for over three years.
- (d) The Cashier's shortages as at 31 December 2013 was Rs. 1,645,074, out of which Rs. 1,561,972 were remained outstanding for more than one year.
- (e) A balance of Rs. 2,699,061 appeared in the Deposit Clearance Accounts for more than five years without being settled.

### **2.3 Non – Compliance with Laws, Rules, Regulations and Management Decisions**

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Instances of Non-compliance with Laws, Rules, Regulations and Management Decisions observed in audit are given below.

#### **Reference to Laws, Rules, Regulations and Management Decisions**

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#### **Non-compliance**

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| (a) Section 47 of the National Savings Bank Act, No.30 of 1971 | In the case of an account had lying dormant, the money held of such accounts should be transferred to the "Unclaimed Deposits Reserve." However, the Bank had not complied with this provision. |
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- (b) Inland Revenue Act, No. 38 of 2000 and the Public Finance Circular No. PF/PE/06 of January 2000
- The Bank had paid a sum of Rs. 63,498,213 as Pay As Your Earn Tax for the year 2013 out of its own funds without being deducted from the salaries of the respective employees.
- (c) Inland Revenue Act, No.10 of 2006 amended by Act, No. 10 of 2007
- (i) In 82 instances tax declaration statements along with the applications had not been obtained from customers by 6 Branches at the time of opening accounts.
- (ii) Four customers had submitted their tax declaration along with their assessable income stating that their assessable income not exceeding Rs. 500,000. Nevertheless, the total interest income credited to their deposit accounts had been exceeded such amount and it was totalled Rs. 2,868,363.
- (d) Paragraph 5.2.4 of Chapter 5 of Public Enterprises Circular No. PED/ 12 dated 02 June 2003
- Even though a draft budget should be submitted for the approval of Board of Directors three months before the commencement of the financial year, the Bank had not complied with this Circular instruction when obtaining the Board approval for the annual budgets for over last five years.
- (e) Government Procurement Guidelines of the National Procurement Agency Circular No. 8 of 25 January 2006 as amended by the Circular No. 06 of 05 October 2006
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- (i) Guideline 4:2:1
- A Master Procurement Plan for the year 2013 had not been prepared.
- (ii) Guideline 4:2:2
- The Procurement Time Schedule for the year 2013 had not been prepared as requested.
- (iii) Guideline 8.9.3
- A formal contract agreement should be entered with the contractor in respect of contract value exceeding

Rs. 500,000. Nevertheless, this requirement had not been fulfilled in 06 instances for the procurement of goods valued at Rs. 124,029,624.

### 3. Financial Review

#### 3.1 Financial Result

According to the Bank's financial statements presented, the operations of the Bank during the year under review had resulted in a pre-tax net profit of Rs. 2,279 million as compared with the corresponding pre-tax net profit of Rs. 6,340 million in the preceding year thus indicating a deterioration of Rs. 4,061 million or 64 per cent in financial results. The significant increase in the interest cost rather than the increase of interest income had been the main reason for this deterioration in the financial results.

The operations of the Subsidiary of the Bank during the year under review had resulted in a pre-tax net profit of Rs. 390 million as compared with the corresponding pre-tax net profit of Rs. 52 million in the preceding year thus indicating an increase of Rs. 338 million in the financial results.

#### 3.2 Analytical Financial Review

According to the information made available, the following table gives the some important accounting ratios of the Bank as compared with the previous year and sector ratios.

	<b><u>Sector Ratio</u></b>	<b><u>2013</u></b>	<b><u>2012</u></b>
(a) <u>Profitability Ratios</u>			
(i) Return on average Shareholder's Funds (Equity) (%)	9.5	5.15	16.07
(ii) Return on Average Assets (%)	0.9	0.39	1.30
(iii) Net Interest Margin	1.43	1.7	2.7
(b) <u>Capital Adequacy Ratio</u>			
Equity to Total Assets	1:18.83	1: 29.45	1: 21.41

(c) Liquid Assets Ratio

Liquidity Ratio (%)	69.53	92.7	69.5
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The following observations are made in this regard.

The return on equity, return on average assets and the net interest margin had been decreased during the year under review by 67.95, 70 per cent and 37.04 per cent respectively as compared with the previous year while the liquidity ratio had been increased by 33.38 per cent.

#### 4. Operating Review

##### 4.1 Performance of the Bank

- (a) According to the information made available, the performance of the operation of the Bank during the year under review as compared with the preceding year is given below.

	<u>2013</u>	<u>2012</u>
Number of Branches	229	219
Number of Postal Branches	4,063	4,053
Number of Account Holders (Mn.)	17.9	17.4
Number of ATMs	247	231
School Bank Units	1,723	1,185

Ten Branches had been newly established during the year under review and the number of account holders had increased approximately 500,000 and the ATM network had increased from 231 to 247 during the year under review.

(b) Profit for the year 2013 and the Branches Running at Loss

- (i) The profit after tax of the Bank for the year 2013 was Rs. 1,184 million. There was a significant decrease of 69 per cent or Rs.2, 579 million as compared with the year 2012.

- (ii) Thirty three Branches and 02 Divisions had been continuously running at a loss of Rs. 207,872,445 and Rs. 148,024,445 in the year 2012 and 2013 respectively.
- (iii) The total loss incurred by 43 Branches and 02 Divisions during the year 2013 was Rs. 209,563,299.

#### **4.2 International Bond Issue – 2013**

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According to the Cabinet decision No.12/1767/504/163 of 19 December 2012 the Cabinet granted its approval to issue the International Bonds amounting to US Dollars 1,000 million and use this proceeds to offering loans for the infrastructure development projects. Accordingly the Bank had received the bond proceeds of US Dollars 750 million at an interest rate of 8.875 per cent per annum on 18 September 2013.

The following observations are made in this connection

- (i) As per the Cabinet decision and Offering Memorandum of the bank, it had been directed to invest 50 per cent out of the bond proceed in Sri Lanka Development Bonds, 25 per cent in US Dollar denominated loans and 25 per cent in Sri Lankan rupee denominated loans. Even though 50 per cent of the proceed had been invested in Sri Lanka Development Bonds, only US Dollar 15.5 million or 8.3 per cent had been invested in the US Dollar denominated loans as at 31 December 2013.
- (ii) Further, the Bank had not disbursed any amount of the bond proceed for the Sri Lankan rupee denominated loans by 31 December 2013.

#### **4.3 Delays in Construction Works**

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The lands at Panadura, Bambalapitiya and Negembo valued at Rs.144, 509,414 had been acquired in the year 2008 and 2009 for the construction of Bank Branches. However, the construction works had not been completed even by 31 December 2013. Thus the rental amounting to Rs. 27,405,300 had been paid for the rent out buildings in order to running these Bank Branches. If the construction works could be completed within the stipulated time period, it would have been able to save this rent payment.

#### 4.4 Loan Administration

(a) Details of loans granted and loans fell to non- performing of the Bank for the years 2013 as compare with the previous year are given below.

Category of Loan	2013				2012			
	Total Loans		Non - performing Loans		Total Loans		Non - performing Loans	
	Number of Loans	Amount Rs. Mn.	Number of Loans	Amount Rs. Mn.	Number of Loans	Amount Rs. Mn.	Number of Loans	Amount Rs. Mn.
Alankara Loans	83	66.3	6	4.22	80	60.67	7	6.33
Auto Loans	297	301.56	2	1.07	143	143.63	2	2.47
Commercial Loans	2	1,192.96	-	-	1	725.95	-	-
Foreign Loans	233	387.02	61	111.34	207	392.35	43	85.58
Government Loans	31,133	21,112.56	1,462	813.89	24,885	17,123.2	664	395.34
House and Property Loans	31,034	22,962.48	4,116	2,172.77	31,077	22,250.8	3,643	1,995
House and Property Loans - Mihindu	4	3.99	3	1.8	19	17.21	7	7.17
National Housing Development- Jana Sewana	5	2,476.00	-	-	4	1,458.43	-	-
Personal Loan on Guarantee	30,488	5,440.63	1,770	175.1	18,630	3,127.13	1,199	83.99



Personal Loans on								
Mortgage	183	154.37	34	37.39	210	178.56	40	35.10
Project Loans	21	15,872.53	-	-	12	7,664.22	-	-
Staff Loans	10,133	3,232.94	-	-	10,015	3,012.86	-	-
University Staff								
Loans	191	174.49	78	6.55	63	51.75	1	1.00
Rata Ithuru Loans	574	33.32	427	20.57	638	29.30	482	18.70
<b>Total</b>	<b>104,381</b>	<b>73,411.15</b>	<b>7,959</b>	<b>3,344.72</b>	<b>85,984</b>	<b>56,236.1</b>	<b>6,088</b>	<b>2,630.6</b>
							<b>9</b>	<b>8</b>

The following observation is made.

The value of total non-performing loans represents 4.7 per cent and 4.5 per cent as a percentage of total loan value of the years 2012 and 2013 respectively.

(b) **Unrecovered Staff Loans**

- i. The value of the loans recoverable at the time of retirement of officers remained unrecovered as at 31 December 2013 amounted to Rs.11, 859,246.
- ii. A sum of Rs. 6,746,567 recoverable from 69 officers interdicted and vacated posts as at 31 December 2013 had been included in the Employees' Loans shown in the statement of financial position as at 2013.

(c) **Project Loans Granted to Construction of a Housing Scheme**

Two loans amounting to Rs.50 million and Rs. 30 million had been granted to a private company at an interest rate of 20 per cent for the above purpose during the year 1996. This loan was expected to be fully settled by July 1999.

The following observations are made in this connection.

- (i) The entire loan remained as arrears without any instalments being paid.
- (ii) The interests paid to the Bank with regard to the above loans as at 06 November 2004 were only Rs. 8,524,520 and Rs. 1,546,028 respectively.

- (iii) According to the Board decision dated 10 March 2006, the extent of the property acquired on behalf of these loans was 6 Acres, 3 Roods and 21.75 Perches. Even though, according to the relevant valuation reports and the survey plans, the extent of the property was 6 Acres, 2 Roods and 12.8 perches and as such a difference of 1 Rood and 8.95 perches were observed.
- (iv) As a result of not recovering the above loan, the interest income and capital receivable to the Bank as at 31 December 2004 amounted to Rs. 185,400,000.
- (v) A part of the above property valued at Rs. 184 million had been vested by Sri Lanka Navy and the property worth of Rs.113 million is belonging to the Bank. However, according to the valuation report obtained by the bank it was only Rs.70.3 million and as such a loss of Rs. 9.7 million had been incurred by the Bank.
- (vi) Four blocks of the above lands valued at Rs. 18.8 million had been acquired by the Government by publishing the notice in the Gazette Extra Ordinary No. 1604/16 of 2 June 2009 and 1708/24 of 02 June 2011. So far, the Government had not paid any compensation in this regard.

(d) **Pawning Advances**

The following observations are made.

- i. The market value of pawning advances had been gradually decreased due to continuous drops in the market prices of Gold during year 2013.
- ii. Although three public auctions had been conducted during the year under review, 52,354 unredeemed pawning articles valued at Rs. 3,995. 4 million were remained in custody of the Bank without auctioning.
- iii. At the audit test check carried out in 09 Branches relating to pawning of gold articles, it was revealed that the payments amounting to Rs.

22,124,812 was made in 68 instances which the ratio of the gold had been lower than the standard ratio.

#### 4.5 Management Inefficiencies

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The following observations are made.

- (a) The misappropriation of funds in 24 Branches of the Bank was Rs. 23,193,414. Of that, 7 per cent related to periods of over 5 years .The total amount exceeding 01 year had been 54 per cent of the overall amount misappropriated.
- (b) Eight building sites costing Rs. 44, 883,096 had been included in work in progress without any construction.
- (c) It was observed that the Bank had failed to achieve the following targets as expected to perform during the year 2013.

Item	Target	Achievement	Non Achievement
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			-
Growth in Deposits	14 per cent	10 per cent	4 per cent
Total Deposits (Rs. Bn)	560	502	58
Return on assets (Number of Times)	1.8	0.18	1.62
Profit Before Tax (Rs. Bn)	7.1	2.3	4.8
Deposit per Employee (Rs. Mn)	183	170	13
Profit per Employee (Rs. Mn)	2.32	0.8	1.52

#### 4.6 Transactions of Fraudulent Nature

The particulars of transaction of fraudulent nature observed during the course of audit are given below.

<b>Branch</b>	<b>Nature of Transaction</b>	<b>Value</b>	<b>The Weaknesses Observed in the Internal Control</b>
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		<b>-Rs. Mn.</b>	
Badulla	(a) Dud articles	8.6	<ul style="list-style-type: none"> <li>i. Failure to secure the confidentiality of the passwords provided to officers.</li> <li>ii. Not verified the authenticity of the customers' signature by particular officers of the Branch.</li> <li>ii. Not conducted the daily physical verification of pawned articles by the manager at the end of the day.</li> <li>v. Failure to verify the pawned articles before sent them to the safe by the officers hold the keys of the safe.</li> </ul>
	(b) Loans against Fixed Deposits	8.7	<ul style="list-style-type: none"> <li>v. Unable to obtain the source documents in a case where the advances for the pawned articles were given.</li> <li>i. Allow to handle whole processes of account opening for a same officer/ employee.</li> <li>ii. Failure to carry out daily auditing on the documents and vouchers relevant to the loans granted on fixed deposits.</li> <li>iii. Failure to properly maintain the stock register of fixed deposit certificates and inadequate internal control over the stock handling relating to fixed deposit certificates.</li> </ul>
Rathnapura	(a). Fraudulent withdrawal of fixed deposit owed to death persons	4.34	<ul style="list-style-type: none"> <li>i. Allow to open a new account through the Point of Sales (POS) machine even though it is prohibited to open such accounts by using this machine.</li> </ul>

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|---------------------------------|------|--|
|                                 |      | ii. Allow to appointing the school leavers and office assistants as cashiers who had recruited on contract basis.  |
| (b). Fraudulent cash withdrawal | 0.51 | i. Failure to check the register of closing accounts and audited on daily basis by the responsible officers.<br>ii. Unable to cancel and file the fixed deposit certificates in time in the case of closing the fixed deposit accounts.<br>iii. Allow to use the office assistances who had recruited on contract basis in the banking functions, even though it had not allowed in the service agreement.<br>iv. Failure to maintain the passbook stock with safety and under proper supervision. Further, not daily update the passbook stock register.<br>v. Allow to accepting deposits and making payments by the staff without due care. |

#### 4.7 Uneconomic Transactions

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The following observations are made.

- (a) The Sri Lanka Navy had acquired the land with extent of 0.479 hectare valued at Rs.35million at Chatham Street which had been purchased by the Bank on 29 January 2009. The acquisition of land had been published in the Gazette of the Democratic Socialist Republic of Sri Lanka and the inspection for compensation had been carried out on 28 June 2012. The Divisional Secretary of Colombo had stated that compensation and interest thereon would be paid on the valuation from the date of inspection. However, no any compensation had been received even up to the end of the year under review.

- (b) A sum of Rs. 35,228,367 had been spent since 2008 to build a 18 storied building for the Bank. This had been shown in the work in progress without any construction carried out during the previous years due to this area is coming under high security zone. Therefore the expenditure incurred thereon could be cited as a fruitless expenditure.

#### **4.8 Investments**

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The following observations are made.

- (a) The overall cost of investments in shares of 55 quoted companies as at 31 December 2013 amounted to Rs. 7,950,328,654. Of these, a sum of Rs. 2,814,456,826 representing 35.4 per cent had been invested in 3 quoted companies on long term basis. The market value of shares of 49 companies out of 55 quoted companies had diminished in value by Rs. 1,922,908,845 during the year 2013 whereas the market value of shares of 6 companies only had improved by Rs. 220,049,608. Accordingly, it was observed that the market value of overall shares invested had diminished by Rs. 1,702,859,237 as at 31 December 2013. The investment cost of companies where the market value had diminished as at 31 December 2013 was Rs. 5,593,802,836.
- (b) There were 4 unquoted equity securities amounting to Rs. 1,267,575,023 as at 31 December 2013. The dividend income from one equity security of Rs. 57,363,543 alone amounted to Rs. 6,090,000. Accordingly, the total return on unquoted equity securities in 2013 had been a low value of 0.48 per cent.
- (c) There was no return for the years 2011, 2012 and 2013 with regard to the investments of Rs.1,210,211,480 made in 03 equity securities as at 31 December 2013. There was no return in 2010 too on an investment of Rs.1,136,500,000 included in these investments.
- (d) The total return on the Com Trust Equity Fund (Unit Trust) investment of Rs. 10,000,000 for the total holding period (20 years) was only Rs.7,550,307 representing 3.85 per cent per annum. The average interest rate paid by the Bank for fixed deposits during the last 21 years ranged from 11 per cent to 13 per cent per annum. As such considering the average interest paid to the customers, the Bank was deprived of a return on Unit Trust ranged from Rs. 14,033,589 to Rs. 17,959,068.

#### 4.9 Human Resources Management

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The following observations are made.

- (a) Details of the approved and actual cadre of the Bank as at 31 December 2013 are given below.

Category	Approved Cadre	Actual Cadre	Number of Vacancies
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Executive Grade	833	626	207
Supervising Grade	919	630	289
Non Staff Grade	1,952	1,602	350
Minor Staff	52	50	02
Others (Contract Basis)	-	34	-
<b>Total</b>	<b><u>3,756</u></b>	<b><u>2,942</u></b>	<b><u>848</u></b>

The approved cadre of the Bank for the year under review was 3,756 and the Bank had deployed 2,908 employees on permanent basis and 34 employees on contract basis comprising 02 posts in executive grade and 32 posts in non- staff grade during the year 2013. Further, action had not been taken to fill 848 vacancies even by 31 December 2013.

#### 5. Systems and Controls

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The deficiencies observed in systems and controls during the course of audit were brought to the notice of the Chairperson of the Bank by my detailed report issued in terms of Section 13 (7)(a) of the Finance Act. Special attention is needed in respect of the following areas of control.

- (a) Accounting
- (b) Budget
- (c) Loan Administration
- (d) Inventory Control
- (e) Documentation
- (f) Compliance with Laws, Rules and Regulations
- (g) Assets Management
- (h) Opening and Closing of Customer Accounts