

The Central Bank of Sri Lanka (CBSL) - 2013

The audit of financial statements of the Central Bank of Sri Lanka (CBSL) for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement 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 and Section 42 (2) of the Monetary Law Act, No. 58 of 1949. In carrying out this audit, I was assisted by a firm of Chartered Accountants in Public Practice to examine the compliance with International Financial Reporting Standards.

1.2 Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting 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

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 misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the CBSL'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 CBSL'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 the 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

2.1 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 2013, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following observations are made.

- (a) Value of under mentioned Project expenditure had not been capitalized even though these Projects were completed.

<u>Details of Expenditure</u>	<u>Amount</u>
	Rs.
Modification of Provincial Offices	3,258,939
Fire Escape Staircase	5,364,072
Model Farm	2,404,830
Central Point Building	409,000,000
White Aways Building	400,000,000

2.2.2 Non-Compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance were observed in audit.

Reference to Laws, Rules and Regulations	Non-compliance
(a) Monetary Law Act, No. 58 of 1949	
(i) Section 39	The profits earned by the CBSL after the appropriations and making settlement of dues from the Government of Sri Lanka should be transferred to the General Treasury within 60 days after the closure of the financial year. However, a sum of Rs. 25 billion had been remitted to the General Treasury in 7 instances in 2013 as advance payments from the profit for the year under review and another Rs. 3 billion had been transferred from retained earnings as a balance profit to the Government contrary to the provisions in the Act. Further, according to the financial statements prepared based on the International Financial Reporting System there was a loss of Rs. 24.26 billion. Nevertheless, the distributable profit had been calculated by the CBSL after taking into account of the net foreign exchange revaluation gain of Rs.26.758 billion and “marked- to- market” loss on foreign assets of Rs. 27.892 billion.
(ii) Amendment to the Section 39 (b)	The total shareholders’ equity as a percentage of the difference between the total assets and the assets in gold and foreign currencies should not be less than 100 per cent. However, the ratio maintained by the CBSL, were ranging from 44 per cent to 76 per cent throughout the year under review against the 100 per cent requirement. Governor of the CBSL had informed me that “the capital adequacy ratios were determined by the Monetary Board from time to time as voluntary benchmarks for internal monitoring of the capital adequacy in addition to the ratio of 15

per cent stipulated in the Monetary Law Act. However, with the enhancement of capital of the CBSL to Rs. 50 billion as proposed in the Government Budget 2014, the Monetary Board had decided to rescind the above stated voluntary ratio and to consider prescribing such a ratio annually at the time of approving of the financial statements each year if additional capital would be necessary due to new circumstances on prudential grounds.”

- (b) Inland Revenue (Amendment) Act,
No. 24 of 1997 and the direction given
by the Committee on Public Enterprises

(COPE) on 06 July 2012

The CBSL had paid the Pay As You Earn Tax aggregating Rs.178.1 million and Rs. 138.9 million for the year under review and for the

preceding year respectively from its own funds on behalf of its employees contrary to the provision in the said Act and instructions given by the COPE.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the CBSL for the year under review had resulted in a net loss of Rs.24,265 million as compared with the corresponding net profit of Rs.66,209 million in the preceding year, thus indicating a deterioration of Rs. 41,944 million in the financial results. The foreign exchange revaluation loss was Rs. 26,759 million as compared with the gain of Rs. 25,182 million in the preceding year and the net income from local currency financial asset and foreign currency financial assets were Rs. 11,470 million and Rs. 4,002 million respectively as compared with the net gain of Rs. 24,866 million and Rs. 30,608 million respectively in the preceding year had been the reasons for the decrease in net profit for the year under review.

3.2 Analytical Financial Review

The total net operating income/(expense) of the CBSL for the year under review was Rs.12.8 billion including the net foreign exchange revaluation loss amounting to Rs. 26.8 billion as compared with this of Rs. 75.9 billion, including net foreign exchange revaluation gain amounting to Rs. 25.2 billion in the preceding year representing a decrease of 117 per cent in the total net operating income. Whereas the operating expenses including depreciation and amortization expenses during the year under review was Rs. 9.4 billion as compared with Rs. 7.1 billion for the previous year. Thus indicating an increase of 32 per cent. The changes of the revenue and expenditure of the CBSL during the year under review, as compared with the preceding year are shown below.

	2013	2012	Change	
	Rs.Bn.	Rs.Bn.	Favarable/ (advarse) Rs.Bn.	percentage
Income from foreign currency financial assets	4.0	30.6	(26.6)	87
Expenses on foreign currency financial liabilities	4.4	5.7	1.3	23
Foreign exchange revaluation gain /(loss)	(26.7)	25.1	(51.8)	206
Income from local currency financial assets	11.5	24.8	(13.3)	54
Operational expenses	9.4	7.1	(2.3)	32
Net profit /(loss) for the year	(24.2)	66.2	(90.4)	136

3.3 Operating Review

3.3.1 Activities on Maintenance of Financial System Stability in Sri Lanka

(a) Supervision of Failed Finance Companies

The following observations are made.

- (i) The Monetary Board had granted the approval on 21 March 2011 to write off the outstanding loans and refinance facilities amounting to Rs. 6.1 billion given to 06 failed finance companies during the period of 1988-1994; Subsequently, the Monetary Board had also decided on 01 September 2011 to claim its from liquidation proceeds of the above six failed finance companies which were in liquidation process. Out of the total liquidation proceeds of Rs. 317.1 million, only a sum of Rs. 18.4 million had been received by the CBSL until end of September 2014 after the above decision.
- (ii) A finance company having liabilities to depositors' amounting to Rs. 3.5 billion was bankrupt in 2013 and it had been absorbed to the master plan of consolidation of the financial sector.

3.3.2 Currency Management

The following observations are made.

- (a) It was observed that the movement of the stock of several commemorative coins were very slow, thus indicating that lower public demand thereon. The stock position of such

commemorative coins remained in the vaults as at 31 December 2013 are given below.

Description	Year of Issue	Face Value	Number of Coins Minted	Number of Coins Remained in the Vaults as at 31 December 2013
		Rs.		
2500 Buddha Jayanthi	1957	5	500,000	20,167
3 rd Anniversary of Induction of President R. Premadasa	1993	1	2,500	746
50 th Anniversary of UNO	1995	5	5,000	3,948
50 th Anniversary of Independence of Sri Lanka	1998	1,000	25,000	6,678
Cricket World Cup- 1996	1999	1,000	25,000	10,153
2550 Buddha Jayanthi	2006	2,000	10,000	8,416
2550 Buddha Jayanthi	2006	1,500	20,000	18,687
Cricket World Cup- 2007	2008	1,000	10,000	7,981

- (b) Currency notes of Central Bank of Sri Lanka had been printed by a private company in Biyagama on behalf of Government of Sri Lanka. Out of the currencies printed by the above company, 2,835 notes in denomination with Rs.1,000 and Rs.500 which were halfly printed had been stolen by an employee of that company and it was published in the newspapers on 02 July 2014. Further, the destruction of damaged notes and removable of printing papers after printing of currency notes had been done under the supervision of the officers of the Currency Department and Management Audit Department of the CBSL. However, it was revealed in the audit that the said destructions had not been supervised by the CBSL after 21 March 2013. The value of damaged notes were Rs.1,417,500.

3.5 Human Resources Management

The following observations is made.

Eighteen employees of the CBSL had released to other Government Institutions by 31 December 2013 and the cost incurred by the CBSL during the year under review was Rs. 38.4 million. Out of that a sum of Rs. 13.6 million had only been reimbursed from the Ministry of Finance and Planning

3.6 Contract Administration

The following observations are made.

- (a) The CBSL had acquired the leasehold right of the Transworks Square Land with the extent of 133.98 perches by spending a sum of Rs. 100,485,000 for a period of 99 years, with effect from 02 June 2000 for the use of the land as a vehicles park for the vehicles of the CBSL and staff officers. Subsequently, the block of the land was re- possessed by the Urban Development Authority (UDA) with a view to implement a development project with a foreign investor without canceling lease agreement signed in the year 2000. Further, the UDA had not entered into a new agreement with the CBSL in order to settle the lease consideration. The book value of the leasehold land as at end of the year under review was Rs. 88,558,750. According to the CBSL's estimate the market value of the land was about Rs. 1,200 million. The CBSL had not taken formal action to recover the paid upfront lease premium from the UDA other than sending some reminders.
- (b) The CBSL had purchased a building in Baron Jayathilaka Mawatha, Colombo-1 (White Aways Building) in the year 2012 from the Ministry of Public Administration for Rs. 500 million based on the valuation made by the Government Chief Valuer, and a sum of Rs. 75.7 million had been spent for the renovation of the building. According to the decision made by the senior management of the CBSL, the purposes of the acquisition of this building were to have additional premises at separate locations as a risk management measure and to facilitate the medium and long term expansion of some Department of the CBSL. Nevertheless, on the ground of available extra building spaces to the CBSL in the main building premises as well as at two separate buildings which were already acquired, the decision to acquire another building for the purpose of risk management measures may be a questionable matter.
- (c) The CBSL had acquired a building in New York by spending US\$ 6,207,116 (Rs. 607,121,953) on 24 August 2011. Without using the building for CBSL own purposes, it was rented out to Ministry of Foreign Affairs for three years period from 01 June 2012 at a monthly rental of US\$ 68,000. Further, the Section 117 of Monetary Law Act, indicates that,

“ the CBSL 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”. In this regard the Governor of the CBSL had informed me that “ *the Central Bank purchased the New York property when the property market in the USA was at depression, with the intention of using it for Bank's future operations when the country's economy moves toward an upper middle income category. Until such times the Central Bank requires this building for its own purposes, it has been rented out to the Ministry of Foreign Affairs of the Government of Sri Lanka to ensure proper utilization of the property.*”

3.7 Matters in Contentious Nature

The CBSL had entered in to an agreement with a foreign Company on 16 March 2013 for a period of one year in order to achieve the following objectives,

- (a) To adhere the political environment in the United States of America (USA) that is more conducive to enhancing Sri Lanka's long term political and economic aspiration;
- (b) To provide a comprehensive information platform where decision-makers in the USA receive clear and accurate information about Sri Lanka's current achievements and future plans; and
- (c) To bring a higher volume of private sector investment to Sri Lanka from the USA.

According to the agreement, the total service fee agreed for the year was Rs. 100 million and any extra services will be paid separately. Out of the above service fee a sum of Rs. 77.4 million had been paid to the above foreign company up to 31 December 2013. However, the promotion, projection and protection internationally of Sri Lanka's national interests in accordance with the foreign policy of the Government of Sri Lanka is a responsibility of the Ministry of External Affairs. Therefore, involving in the above activities by the CBSL is contradict to the objectives of the CBSL.

4. Systems and Controls

Deficiencies in systems and controls observed in audit were brought to the notice of the Governor of CBSL from time to time. Special attention is needed in respect of the following areas of control.

- a) Currency Management
- b) Supervision of Non- Banking Activities.
- c) Contract Administration
- d) Human Resources Management
- e) Accounting for Properties