

## **People’s Bank – 2014**

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The audit of consolidated financial statements of the People’s Bank (“ the Bank”) and the consolidated financial statements of the Bank and its Subsidiaries (“Group”), for the year ended 31 December 2014 comprising the statements of financial position as at 31 December 2014, the income statements, statements of profit or loss and other comprehensive income, statements of changes in equity and statements of cash flow 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 . To carry out this audit I was assisted by a firm of Chartered Accountants in public practice. At the meantime 40 firms of Chartered Accountants in public practice assisted to audit of 40 Branches of the Bank. The financial statements of the Subsidiaries were audited by the firms of Chartered Accountants in public practice appointed by the members of the respective Subsidiaries. Detailed audit reports in respect of the Branches were furnished to the Bank from time to time between the period of 18 February to 22 April 2015. Some of the comments and observations contained in those reports are summarized in this report.

The Bank has been exempted from the provisions of Part II of the Finance Act, No. 38 of 1971 by an order of the Minister of Finance and Planning published in the Government Gazette No. 715 of 14 May 1992 by virtue of powers vested in him by Section 5(1) of the said Finance Act. The Bank is also exempted from all Treasury and Public Administration Circulars as decided by the Cabinet of Ministers and conveyed by the Secretary to the Treasury by his Circular No. EA 02/BC/PB/01 dated 10 April 1992.

This report is issued in terms of Article 154(6) of the Constitution of Democratic Socialist Republic of Sri Lanka.

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

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The Board of Directors (“Board”) is responsible for the preparation of these consolidated financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the Board determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. 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 consolidated financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 Board, as well as evaluating the overall presentation of the consolidated financial statements.

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

## **2. Consolidated Financial Statements**

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### **2.1 Opinion – Bank**

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In my opinion, the consolidated financial statements give a true and fair view of the financial position of the People’s Bank as at 31 December 2014, 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 of the Bank and its Subsidiaries give a true and fair view of the financial position of the Group as at 31 December 2014, and their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### **2.2 Comments on Group Financial Statements**

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The consolidated financial statements of the Bank comprised the financial statements of the Domestic Banking Units and the Offshore Banking Unit which are an integral part of the Bank. The Group financial statements comprised the consolidated financial statements of the Bank, its Subsidiaries and Associates in compliance with Sri Lanka Accounting Standards (LKAS). The Bank had owned 99 per cent of the share capital of the People’s Travels (Pvt) Ltd., 75 per cent of the People’s Leasing and Finance PLC., 26.13 per cent of the People’s Merchant Bank PLC and 37.3 per cent of the Smart Net Lanka (Pvt) Ltd at the balance sheet date.

The ownership of the Bank as at 31 December 2014 as compared with the preceding year in respect of each Subsidiary and Associate is as follows.

<u>Name of the Subsidiaries</u>	<u>Direct Investments</u>			
	<u>2014</u>	<u>Percentage</u>	<u>2013</u>	<u>Percentage</u>
	<u>Rs.000</u>		<u>Rs.000</u>	
People’s Travels (Pvt) Ltd	4,950	99	4,950	99
People’s Leasing and Finance PLC	1,040,958	75	1,240,958	75
Total investment in Subsidiaries	<b>1,045,908</b>		<b>1,245,908</b>	

### Name of the Associates

People’s Merchant Bank PLC	273,100	26.13	273,100	26.13
Smart Net Lanka (Pvt) Ltd	25,000	37.3	25,000	37.3
Total investment in Associates	298,100		298,100	
Less – Provision for Impairment				
People’s Merchant Bank PLC	-		(65,532)	
Smart Net Lanka (Pvt) Ltd	(25,000)		(25,000)	
Net investment in Associates	<b>273,100</b>		<b>207,568</b>	

## **2.3 Comments on Consolidated Financial Statements of the Bank**

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### **2.3.1 Sri Lanka Accounting Standards (LKAS)**

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The following observation is made.

#### **LKAS 39 - Financial Instruments: Measurement and Recognition**

The Bank had recognized the value of financial assets held to maturity based on the simple interest method, instead of being amortized the same by using Effective Interest Rate (EIR). Hence, there was a difference of Rs. 5,825,679 between the amortized value and the value recognized in the financial statements. Further, the Bank had recognized the interest income for Treasury Bonds (TB) on a simple interest base instead of being recognized by using Effective Interest Rate (EIR).

### **2.3.2 Unexplained Differences**

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The following unexplained differences were observed.

- (a) An unexplained difference of Rs. 333,065,000 was observed between the amount shown in the People’s Automated Banking System (PABS) and the balance reported under the General Ledger relating to the loans on pawning.
- (b) A difference of Rs. 6,542,966 had been observed between the fixed deposits and savings accounts balances reported in Silverlake Integrated Banking System (SIBS) Data Warehouse and the balances shown in the General Ledger.

### **2.3.3 Suspense Accounts**

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A sum of Rs. 204,459,968,000 had remained in 07 suspense accounts without being cleared even by 31 December 2014.

### **2.3.4 Lack of Evidence for Audit**

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The Bank had purchased 9,030,000 shares from the Regional Development Bank at a cost of Rs. 90,300,000 on 27 November 2014. However, share certificates for the investment had not been furnished to audit for perusal although they were called for.

## **2.4 Non-compliance with Laws, Rules, Regulations and Management Decisions**

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The following instances of non compliances were observed in audit.

<b>Reference to Laws, Rules, Regulations and Management Decision</b>	<b>Non-compliance</b>
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(a) People’s Bank Act, No. 29 of 1961	Authorized share capital of the Bank was limited to 20 million ordinary shares. Although the Bank had issued only 999,960 shares, the capital pending allotment was amounting to Rs. 7,152 million equal to 143,040,000 shares which exceeds the authorized share capital as mentioned in the Act. However, a sum of Rs. 7,152 million was held in a capital pending allotment account as authorized share capital which is yet to be increased by amending People’s Bank Act.
(b) Guidelines of the Central Bank of Sri Lanka  No.02/17/402/0073/001 of 12 April 2005	All Licensed Commercial Banks were required to increase their capital up to Rs. 2,500 million by the end of 2007 in terms of Guidelines of the Central Bank. However, the Central Bank of Sri Lanka had permitted to few Banks who had not achieved that required capital, to enhance the amount at least by 50 per cent by end of the year 2006 and to completely reach Rs. 2,500 million by end of 2007. However, the Bank had not reached the required capital and the deficiency that existed as at 31 December 2014 amounted Rs.2,450 million.

## **3. Financial Review**

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### **3.1 Financial Results**

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According to the consolidated financial statements presented, the operations of the Bank and the Group for the year ended 31 December 2014 had resulted in a pre-tax net profit of Rs.17,231 million and Rs. 21,627 million respectively as compared with the corresponding pre-tax net profit of Rs. 10,304 million and Rs. 13,412 million of the Bank and the Group respectively for the preceding year, thus indicating an improvement of Rs. 6,927 million and Rs. 8,215 million in the financial results respectively. This was mainly due to decrease of impairment loss on financial assets of the Bank and the Group by Rs. 15,146 million and Rs.14,490 million respectively.

### 3.2 Analytical Financial Review

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#### 3.2.1 Summary of the Financial Results

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The following table gives a summary of the financial results at various stages for the year under review and the preceding year

	Year ended 31 December			
	2014		2013	
	Bank	Group	Bank	Group
	Rs. million	Rs. million	Rs. million	Rs. million
Interest Income	84,480	104,181	110,440	129,205
Interest Expenses	<u>(54,362)</u>	<u>(64,211)</u>	<u>(73,791)</u>	<u>(84,245)</u>
<b>Net Interest Income</b>	30,118	39,970	36,649	44,960
Other Income	<u>11,776</u>	<u>14,338</u>	<u>9,880</u>	<u>10,616</u>
<b>Operating Income</b>	<b>41,894</b>	<b>54,308</b>	<b>46,529</b>	<b>55,576</b>
Impairment for Loans and Other Losses	1,430	118	(13,716)	(14,822)
Net Operating Income	43,324	54,426	32,813	40,754
Operating Expenses	<u>(22,455)</u>	<u>(28,800)</u>	<u>(20,803)</u>	<u>(25,249)</u>
<b>Operating Profit before Value Added Tax (VAT)</b>	20,869	25,626	12,010	15,505
VAT on Financial Services	<u>(3,638)</u>	<u>(3,979)</u>	<u>(1,706)</u>	<u>(2,016)</u>
<b>Operating Profit after VAT</b>	<b>17,231</b>	<b>21,647</b>	<b>10,304</b>	<b>13,489</b>
Share of Profit/ (Loss) of Associates	-	(20)	-	(77)
<b>Profit before Tax</b>	<b>17,231</b>	<b>21,627</b>	<b>10,304</b>	<b>13,412</b>
Tax Expenses	(3,012)	(4,674)	(2,816)	(4,248)
<b>Profit for the Year</b>	<b>14,219</b>	<b>16,953</b>	<b>7,488</b>	<b>9,164</b>

#### 3.2.2 Significant Accounting Ratios

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Certain significant ratios for the year under review and the preceding four years as compared with the Central Bank of Sri Lanka (CBSL) norms are given below.

	CBSL Norms	Actual in percentage				
		2014	2013	2012	2011	2010
(a) Capital Adequacy Ratio (Tier 1)	5.00	10.9	10.4	9.8	9.6	7.9
(b) Capital Adequacy Ratio (Tier 1+Tier 2)	10.00	14.3	15.0	14.0	14.5	12.8
(c) Return on Assets	-	1.8	1.1	2.0	2.6	1.7
(d) Performing Advances to Total Advances	-	3.2	5.3	2.8	3.4	5.0
(e) Liquidity Ratio						
- Domestic Banking Unit	-	30.3	25.2	21.8	21.5	23.4
- Foreign Currency Bank Unit		21.8	22.3	21.8	24.0	22.3

#### 4. Operating Review

##### 4.1 Performance

##### Branch Performance and Profitability

According to the information made available, out of 346 Branches 291 Branches had been able to record a total profit of Rs. 10,048 million before reallocated expenditure, while 55 Branches had been recorded a total loss of Rs. 1,013 million for the year under review. Accordingly the net profit of 346 Branches was Rs. 9,035 million before the reallocated expenditure over the preceding year net profit of Rs. 10,293 million, thus indicating a decrease of Rs. 245 million or 2 per cent in the financial results.

According to the zonal wise profit/(loss) for the year 2014, the Bank had recorded a profit of Rs. 3,168 million after reallocated expenditure over the preceding year loss of Rs. 2,594 million after reallocated expenditure, thus indicating an improvement of Rs. 5,762 million or 222 per cent in zonal wise profitability.

The zonal wise Branch network of the Bank and their profitability for the year ended 31 December 2014 as compared with the proceeding year are given below;

Zone	2014		2013	
	Number of Branches	Profit/ (Loss) Rs. million	Number of Branches	Profit/ (Loss) Rs. million
Central Zone	43	885	43	851
Eastern Zone	29	(242)	29	118
North Central Zone	27	502	27	282
Southern Zone	41	845	41	748
Sabaragamuwa Zone	32	784	32	833

Western Zone I	58	3,425	58	4,569
Western Zone II	39	1,473	38	1,452
Wayamba Zone	31	905	31	951
Northern Zone	21	(61)	21	39
Uva Zone	25	519	25	450
<b>Total</b>	<b>346</b>	<b>9,035</b>	<b>345</b>	<b>10,293</b>
Less:				
Reallocated Expenditure		(5,867)		(12,887)
<b>Profit/(Loss) After Reallocated Expenditure</b>		<b>3,168</b>		<b>(2,594)</b>

#### **4.2 Loan Administration**

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The following observations are made.

##### **(a) Loans Written off**

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Capital and Interest relating to outstanding loans and advances amounting to Rs.24,831,237 had been written off during the year under review.

##### **(b) Non-Performing Loans (NPL)**

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The following observations are made in this connection.

- (i) It was observed that there were outstanding loan balances of Rs. 361,688,737 relating to 74 loans over one million within 18 Branches which had not been paid at least a single instalment.
- (ii) Loans granted to two State Owned Enterprises had remained in NPA Section since 2006. The total outstanding as at 31 December 2014 was Rs. 363,794,287.
- (iii) Non- performing Loans and Overdrafts of the major ten customers aggregating Rs. 6,878,244,564 and Rs. 631,248,295 respectively had remained as at 31 December 2014.
- (iv) At the audit test check carried out, it was revealed that the Loans and Overdraft facilities aggregating Rs.150,020,348 granted by under mention Branches to the customers had been subsequently categorized as Non-Performing Loans without being taken timely or proper actions to recover the outstanding balances. The total outstanding balances remained as at 28 April 2015 were Rs. 241,309,746. Details are shown below.

Branch	Number of Loan/Overdraft Facilities Given	Granted Period	Total Amount Granted	Amount Outstanding as at 28.04.2015 (Including capital and interest)
			Rs.	Rs.
Ratmalana	09	2008-2012	11,258,450	26,247,657
Kataragama	02	2004-2005	797,861	2,070,419
Thalawakale	05	2006-2013	2,672,474	4,576,708
Kaduwela	14	2006-2011	33,005,307	52,862,432
Nittambuwa	10	2001-2012	15,299,245	75,693,824
Yakkala	12	1996-2013	86,987,011	79,858,706
<b>Total</b>	<b>52</b>		<b>150,020,348</b>	<b>241,309,746</b>

- (v) The Bank should properly evaluate the transactions history before opening a new account for an existing customer. Nevertheless the Rathmalana Branch had opened a new current account for a customer on 07 August 2012, without being evaluated the existing current accounts maintained in other Branches. Subsequently these accounts had been transferred to Non Performing Category. Details are shown below;

Name of the Branch	Date of Account Opened	Date of transferred to Non Performing category	Non Performing Loan Balances as at 27 July 2015
			Rs.
❖ Rathmalana	26.09.2002	03.11.2008	4,532,583
❖ Matara - Uyanwatte	26.07.2007	04.08.2008	1,768,988
❖ Gandara	26.04.2006	24.11.2008	32,604
❖ Gandara	12.07.1999	25.02.2009	434,634
			6,768,809

- (vi) It was observed that the advances aggregating Rs. 13,223,802 granted by 03 Branches in 07 instances had been subsequently categorized as Non-Performing. The total



outstanding balance as at 06 May 2015 was Rs. 34,320,954. Since these advances had been granted without obtaining securities, the recoverability of the advances is in doubt.

Name of the Branch	Amount Granted	Total Outstanding as at 06 May 2015		
		Capital	Interest and others	Total
	Rs.	Rs.	Rs.	Rs.
Ratmalana	3,160,000	3,160,000	4,792,941	7,952,941
	2,120,000	1,456,037	2,502,426	3,958,463
	718,916	694,560	537,044	1,231,604
Kaduwela	680,000	648,470	227,439	875,909
Nittambuwa	4,585,290	4,585,290	8,346,838	12,932,128
	1,382,236	1,382,236	5,101,079	6,483,315
Yakkala	577,360	577,360	309,234	886,594
	<b>13,223,802</b>	<b>12,503,953</b>	<b>21,817,001</b>	<b>34,320,954</b>

**(c) Inadequate Mortgaged Property**

According to the valuation report given by the panel valuers relating to 05 customers under 03 Branches in 2014 the force sale value of the mortgaged property was only Rs.16,921,600. However the total outstanding balance as at 06 May 2015 was Rs.39,063,606 which exceeds the force sale value of the properties by Rs 22,142,006.

Branch	Number of Loans and Overdrafts	Outstanding Balance as at			Forced Sale Value	Difference
		Capital	06 May 2015 Interest and other Charges	Total		
		Rs.	Rs.	Rs.	Rs.	Rs.
Kaduwela	02	4,217,417	3,392,203	7,609,620	2,100,000	(5,509,620)
	02	3,752,630	5,061,979	8,814,609	7,000,000	(1,814,609)
	01	1,161,112	1,039,062	2,200,174	1,100,000	(1,100,174)
Nittambuwa	05	6,587,326	11,524,840	18,112,166	5,000,000	(13,112,166)
Yakkala	03	1,270,025	1,057,012	2,327,037	1,721,600	(605,437)
<b>Total</b>		<b>16,988,510</b>	<b>22,075,096</b>	<b>39,063,606</b>	<b>16,921,600</b>	<b>(22,142,006)</b>

(d) **Lending to State Corporations**

The following observations are made;

i. The Bank had granted several import facilities to a State Corporation and the total outstanding as at 31 December 2014 was Rs.176,038 million. It was observed that this represents 63 per cent of the total outstanding import facilities provided by the Bank as at 31 December 2014. Credit exposure as at 31 December 2014 is as follows.

ii.

Type of Facility	Amount due from the Corporation as at 31 December 2014	Total Outstanding as at 31 December 2014	Percentage of Total Outstanding
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	Rs. million	Rs. million	%
Letter of Credits	26,248.31	57,471.64	46
Letter of Acceptances	29,515.20	43,502.80	68
Foreign Currency Loans	120,273.61	142,338.59	84
Bank Guarantees	1.05	36,863.67	0.003
<b>Total Exposure</b>	<b>176,038.17</b>	<b>280,176.70</b>	<b>63</b>
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iii. The Bank had approved a loan amounting to Rs. 14,585,855,096 and USD 44,717,825 on the Treasury Indemnities to pay selected road contractors on behalf of a Corporation. Accordingly the Bank had paid sums of Rs.13,925,559,767 and USD 39,825,960 to the contractors up to 23 July 2014 only on the recommendation made by an Accountant of the Corporation. However, the Bank had not entered into an agreement or introduced a proper mechanism to evaluate the physical progress of the above Projects before disburse the funds to the contractors. Details are shown below;

Amounts in millions

Road Project	Amount Approved	Date of Granted	Amount Granted	Capital outstanding as at 16.07.2015	Interest due and Penalty charges as at 16.07.2015	Total outstanding as at 16.07.2015
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	Rs.		Rs.	Rs.	Rs.	Rs.
Katuwana-Alupothdeniya (004-8001-	2,328.36	20.03.2012	1,975.36	1,839.12	81.12	1,920.25

000005263

Narammala –  
Giriulla  
(0048001-  
000005281)

	1,400.00	28.03.2012	1,223.16	1,164.82	52.01	1,216.83
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Ibbagamuwa-  
Kumbukgate  
(0048001-  
000005325)

	2,861.81	02.04.2012	2,739.47	2,620.23	117.14	2,737.37
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Anuradapura-  
Trincomalee  
(0048001-  
000005343)

	7,995.68	02.04.2012	7,987.57	7,654.42	465.29	8,119.70
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**Total**

	----- <b>14,585.85</b> =====		----- <b>13,925.56</b> =====	----- <b>13,278.59</b> =====	----- <b>715.56</b> =====	----- <b>13,994.15</b> =====
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Colombo-  
Katunayake  
expressway  
(0048002-  
000000427)

	USD 44.72	29.09.2014	USD 39.82	USD 39.82	USD 1.07	USD 40.90
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**(e) Staff Loans**

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The following observations are made:

- i. Even though non performing staff loan balance had been increased from Rs.260 million to Rs.336 million during the year 2014, the management had not taken effective action to recover these outstanding balances.
- ii. No proper procedure had been introduced for the recovery of outstanding staff loans and advances dues from the staff members who were deceased, interdicted, dismissed, and no pay leave etc.
- iii. Loans amounting to Rs. 14,544,324 granted for staff members who presently serve in the Bank, had been transferred to Non-Performing category. However, adequate actions had not been taken by the Staff Loans Unit to recover those outstanding balances.
- iv. According to the Non Performing schedule prepared by the Staff Loan Division as at 31 July 2014, there was a outstanding balance of Rs. 70,457,707 relating to rejoined employees (after taking disciplinary actions).

- v. The Non Performing outstanding balances amounting to Rs.4,051,844 (Capital Rs. 3,637,282 and Interest Rs. 414,562) which were unsecured from mortgaged property had remained without being recovered from 67 employees. It was further observed that all retirement benefits belong to the retired employees had been paid to them without recovering outstanding balances.
- vi. The Bank had made a provision for staff loans amounting to Rs. 131,360,666 as at 31 December 2013.

**(e) Cash Margin Loans**

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The Cash Margin Loans valued at Rs.34.9 million granted under monthly repayment terms, had been transferred to Non Performing category on 01 February 2015 without being recovered from the existing securities.

**5. Systems and Controls**

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

- (a). Complied with Accounting Standards
- (b). Loan Administration
- (c). Unreconciled Differences
- (d). Suspense Accounts
- (e). Branch Performance and Profitability
- (f). Control over Fixed Assets