

## **Sri Lanka Savings Bank Limited - 2015**

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The audit of financial statements of the Sri Lanka Savings Bank Limited (“the Bank”) for the year ended 31 December 2015, comprising the statement of financial position as at 31 December 2015 and the 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.

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

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

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Board of Directors (“Board”) is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal controls as the management determine 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. 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.

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

### **1.4 Basis for Qualified Opinion**

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- (a) According to the section 15 of the Sri Lanka Accounting Standards (LKAS) 01 - Presentation of Financial Statements: Additional disclosures are required to be presented when necessary, to achieve the fair presentation of financial statements.

However, un-reconciled differences amounting to Rs. 68,537 and Rs. 27,745,091 has been included in the prior year adjustments presented in the Statement of Changes in Equity for the year 2015 and 2014 respectively without any disclosure due to not having adequate evidence with the Bank.

- (b) The Bank had not disclosed the nature and extent of risk arising from financial instruments to which the entity is exposed such as credit risk, market risk, liquidity risk at the end of the reporting period and how they had been managed in terms of Sri Lanka Accounting Standards (SLFRS) 7 - Financial Instruments, Disclosures.
- (c) The Bank had not disclosed the extent to which the fair value of investment property is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and recent experience in the location and category of the investment property being valued as required by Sri Lanka Accounting Standards (LKAS) 40 – Investment property.
- (d) The bank reconciliations had not been aligned with the ledger and a difference of Rs. 30,916,133 was observed between the amounts taken to the bank reconciliation statements and ledger at the end of the year under review.
- (e) Un-reconciled differences were observed between the General Ledger and loan schedule provided in relation to other loan facilities where 06 loan balances had been overstated by Rs.4,606,059 while 03 loans had been understated by Rs.1,462,929 in the ledger.
- (f) An un-reconciled difference of Rs. 6,225,150 was observed between the ledger and loan schedules provided in relation to Lease and Hire Purchases.
- (g) An un-reconciled net difference of Rs. 10,454,038 was observed between the inter branch current accounts and head office current accounts as at the end of the year under review.
- (h) The loan due to General Treasury (Micro Finance Loan to ADB) as per the financial statements as at the end of the year under review was differed by Rs. 2,611,023 with the balance confirmed by the Treasury and this difference had been transferred to the equity without any valid reason.
- (i) The negative loan balances amounting to Rs. 99,428,472 in the ledger could not be satisfactorily verified in audit during the year under review due to non-submission of sufficient and appropriate evidence.
- (j) Documentary evidence were not made available to verify the accuracy, existence, completeness and valuation of other payable balance amounting to Rs. 2,784,406.
- (k) Even though all licensed specialized banks require to enhance minimum capital requirement up to Rs. 5 billion commencing from 01 January 2016 in terms of the Circular No.02/17/402/0073/002 dated 23 December 2014 issued by the Central Bank of Sri Lanka, the total capital of the Bank as per financial statements stood only at Rs.4,343,236,531 as at that date

- (l) A difference of Rs. 625,761 was observed between the general ledger and the savings and fixed deposits schedules provided for the year under review.
- (m) An un-reconciled difference of Rs. 670,430 was observed between the schedule provided and the general ledger with regard to micro finance loan facilities.

**2. Financial Statements**  
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**2.1 Qualified Opinion**  
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In my opinion, except for the possible effects of the matters described in Basis for Qualified Opinion paragraph of this report, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2015, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

**2.1.1 Report on Other Legal and Regulatory Requirements**  
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As required by section 163 (2) of the Companies Act No. 07 of 2007, I state the following:

- i) The basis of opinion and scope and limitations of the audit are as stated above.
- ii) In my opinion, except for the effect of such adjustments as might have been determined to be necessary had I been able to satisfy myself as to the matters disclosed in the basis for qualified opinion paragraph above
  - I have obtained all the information and explanations that were required for the audit as far as appears from my examination, proper accounting records have been kept by the Bank,
  - the financial statements of the Bank, comply with the requirements of Section 151 of the Companies Act.

**2.2 Non – Compliance with Laws, Rules, Regulations and Management Decisions**  
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Instances of non-compliance with the following Laws, Rules, Regulations and Management Decisions observed during the course of audit are given below.

<b>Reference to Laws, Rules, Regulations and Management Decision etc</b> -----	<b>Non compliance</b> -----
(a) Section 2(3) of Economic Service Charges (ESC) Act, No. 13 of 2006.	Interest, discounts, dividend, exchange, service charges, commissions on brokerage or any other income derived by the entity in the course of its business shall be deemed to form part of the turnover of such entity. However, an amount of Rs 3,261,068 earned in the form of fee and commission income during the year under review had not been considered as liable turnover when computing ESC.

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| (b) Section 116 (1) of the Companies Act No. 07 of 2007            | The Bank had not maintained a proper register for entering the interest income of the Bank.   |
| (c) Extraordinary Gazette Notification No.1868/10 of 23 June 2014. | Salaries and allowances aggregating Rs.55,005,674 only had been considered as emoluments at the computation of total value addition for the purpose of Value Added Tax (VAT) and Nation Building Tax (NBT) without taking into account the other personnel expenses of Rs.43,042,135 incurred during the year under review. Hence, VAT and NBT on financial services for the year under review approximately Rs.5,595,478 had been understated in the accounts. |

### **3. Financial Review**

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#### **3.1 Financial Results**

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According to the financial statements presented, the operations of the Bank for the year ended 31 December 2015 had resulted in an pre-tax net profit of Rs. 432,282,566 as compared with the corresponding pre-tax net profit of Rs. 234,854,912 in the preceding year, thus indicating an improvement of Rs. 199,427,654 or 85 per cent in the financial results for the year under review. Decrease of impairment charges on loans and other losses by Rs.242,753,222 as compared with the preceding year was the main reason attributed for this improvement in the financial results.

#### **3.2 Analytical Financial Review**

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##### **3.2.1 Significant Accounting Ratios**

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The following observations are made.

- (a) Capital Adequacy Ratio (Tier 1) of the Bank has decreased from 94 per cent in the year 2014 to 65 per cent in the year 2015. However, it was higher than the requirement rate of 10 per cent by the Central Bank of Sri Lanka.
- (b) Return on Average Assets ratio of the Bank had increased from 3.32 per cent in 2014 to 5.29 per cent in 2015.

#### **3.3 Legal proceedings initiated against and by the Bank**

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According to the information made available, it was revealed that there were 49 unsettled court cases as at the end of the year under review. Out of that, 6 cases were filed by the outsiders against the Bank claiming Rs. 172,182,000 while 43 cases were filed by the Bank against the outsiders claiming Rs. 869,103,253.

#### 4. Operating Review

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##### 4.1 Performance of the Bank

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The following observations are made.

- a) According to the Articles of the Association of the Bank, the main objective of the Bank is to identify, develop, promote, catalyze and support sustainable income generating opportunities and higher quality of life for the poor through a range of activities including productive self - employment micro enterprises and rural works by the provision of financial assistance and services. Accordingly, details of providing financial assistance for each sector based on the financial statements as at 31 December 2015 is given below.

Sector	Amount of Loan Provided Rs.
Agriculture and fishing	962,241,694
Manufacturing	467,236,843
Tourism	20,935,707
Transport	88,603,000
Construction	586,952,449
Traders	516,752,420
New economy	4,709,352
Others	<u>1,522,643,776</u>
<b>Total</b>	<b><u>4,170,075,241</u></b>

The Bank had provided only Rs.1,062,287,025 or 25 per cent of loans out of its total portfolio to micro enterprises in order to comply with set objectives. However, it was observed to be less satisfactorily.

- b) **Settlement of Liabilities of Premuka Savings and Development Bank ( PSDB)**

According to the scheme for meeting the claims of creditors and depositors of PSDB published by the Central Bank of Sri Lanka on 2009, all the remaining liabilities to the creditors and depositors which defaulted by the PSDB shall be paid by the Bank. Accordingly, during the under review the Bank paid Rs. 66,268,341 to such creditors and depositors and balance remaining to be settled before December 2017 was Rs. 2,131,001,482 as at 31 December 2015.

##### 4.2 Operating inefficiencies

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Out of total interest income amounting Rs.676,168,543 for the year under review, a sum of Rs. 449,667,164 or over 67 per cent representing the interest on investments and less than 33 per cent had been earned from the main operations of the Bank which is provision of financial assistance and services.

### 4.3 Management Weaknesses

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The following observations are made.

- a) According to the resolution passed at the Extraordinary General Meeting (EGM) held on 04 December 2015, the proposal for transfer all subscriber shares of the shareholders of the Bank to the General Treasury within one month from the date of the EGM was not implemented till 30 June 2017.
- b) The following decisions taken at the meetings of the Bank had not been implemented by the responsible officers concerned as shown below.

Date of Minute	Details of the Decision	Responsible Officer	Status as at 31 December 2015
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07.02.2015 26.06.2015 28.08.2015 28.08.2015	} Prepare and send a proper recovery plans to all Branches excluding Matara and Anuradhapura } Introduce a new Business Plan during the next 2 or 3 months through ikman.lk for leasing business.	All Managers  GM/AGM	Not prepared  Not introduced
28.08.2015	Introduce a new account for children with insurance cover. (5,000 accounts targeted during 2 or 3 months)	GM/AGM	Not commenced
28.08.2015	Prepare a Business Plan to increase deposits of the Bank	Treasury division	Not commenced

### 4.4 Risk Management

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The following observations were made.

- a) Risk management structure had not been approved by the Board. Although the cadre of the Risk Management Unit with 7 staff was approved by the nomination committee, the Unit is operating with only 3 staff and the key posts such as officers of credit risk, operational risk and marketing risk were remained vacant since the establishment of the Unit.
- b) As per paragraph 4.13.1 of Risk Management Policy of the Bank, credit review officer (Loan review officer) who to be reported independently to the Board regarding the quality of loan portfolio, should be appointed by the Board of Directors. However, such post had remained vacant since the year 2015.
- c) The Board Integrated Risk Management Committee (BIRMC) had not met in the first quarter of the year under review in terms of paragraph 2.4.4 of Risk Management Policy of the Bank.

- d) According to paragraph 2.3 of Risk Management Policy of the Bank, the Board Sub-Committees and Management Committees should support and responsible for coordination of risk matters for each area of the risk management. However, as per the BIRMC meeting minutes, risk matters of the Audit Committee, Asset and Liability Committee (ALCO), Investment Committee, Management Committee, IT Steering Committee and Legal and Recovery Committee had been disregarded by the BRIMC.

#### 4.5 Non performing Loans

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The following observations are made.

- (a) Loans outstanding under Rehabilitation of Persons, Properties and Industries Authority (REPPIA) as at 31 December 2015 was Rs.59,952,654 and out of that Rs.59,447,928 or 99 per cent had been categorized as non performing as at that date.
- (b) Based on the observations of field visits conducted by the Officers of Mannar Branch with regard to 149 REPPIA loans, the Board Credit Committee (BCC) at its meeting held on 11 December 2014 approved to reschedule the REPPIA loans and instructed to include rescheduled information into Bank's application system on or before 31 December 2014. However, the Bank had not taken any favorable action to reschedule such loans as there was no reschedule option in the Bank's application system.
- (c) Hope Micro Finance Services (Guarantee) Ltd

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Three credit facilities (Refinance Scheme, NECDEP Scheme, and Capacity Building Scheme) were granted to Hope Micro Finance Services (Guarantee) Ltd (HOPE) under Micro Finance Loan Scheme. The total outstanding loan balance as at 31 December 2015 was amounting Rs.39,373,610 and subsequently it had been categorized as Non Performing Loan.

The following observations were also made in this regard.

- (i) The loan reschedule approval was granted by the Board on 24 September 2012 due to default from March 2012 and approval for the loan disbursement had been granted by the Working Director of the Bank on 03 October 2012 subject to verification by field inspection prior to next disbursement. However, two disbursements amounting Rs. 2,675,000 and Rs.1,950,000 had been released on 22 October 2012 and 02 November 2012 respectively without conducting such verifications.
- (ii) The field inspection carried out on 24 November 2012 it was observed that the part of the funds granted to the HOPE had not been distributed to the end borrowers. Further, the collected money from borrowers also had been kept by the HOPE without remitting to the Bank. However, there was no evidence supported to audit to verify the actions taken by the Bank to collect said money. Moreover, released of other disbursement amounting Rs.2,000,000 on 04 December 2012 ignoring observations of the field inspection was questionable to audit.

## **5. Accountability and Good Governance**

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### **5.1 Appointment of Directors**

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The following observations were made.

- (a) As per Section 3(2) of the Banking Act Direction on Corporate Governance for Licensed Specialized Banks, the Board of Directors should comprise at least 07 members and not more than 13 members. However, as per letter No.02/19/0319/0001/002 dated 13 November 2015 of the Bank Supervision Department of the Central Bank of Sri Lanka (CBSL), it was declined to grant the approval for appointment of seven (07) persons as Directors of the Bank.
- (b) Further, it has strongly advised to the management that immediately request Secretary to the Treasury to appoint new directors to the Board of the Bank. However, there is no any information made available to justify whether any remedial action had been taken by the management on said matter even as at 31 December 2015.
- (c) According to the above letter, the CBSL has requested to send the affidavits and declarations of two (02) persons who have been appointed as Directors of the Bank in order to assess their fitness and propriety. However, the Bank had not complied with this.
- (d) As per direction 3(1) (iii) of the Banking Act Directions, the Board meetings shall normally involve active participation in person of a majority of Directors entitled to be present. However, 7 Directors out of 11 Directors of the Bank had been disqualified and 2 others were not approved as Directors by the CBSL. Therefore, it was not clarified that whether it is complied with the minimum quorum and assured the fitness and propriety of Directors as per the Directions 3(2) and 3(3) of the Banking Act Direction on Corporate Governance for Licensed Specialized Banks.

### **5.2 Action Plan**

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An action plan had not been prepared for the year 2015 in accordance with the paragraph 5.1.2 of the Department of Public Enterprises Circular No. PED/12 dated 02 June 2003. However, the Board of Directors had given their approval for unavailable Action Plan on 28 April 2015 by Board paper No. 71/2015.

### **5.3 Budgetary Control**

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As per paragraph 5.2.3 of the Department of Public Enterprises circular No. PED/12 dated 02 June 2003, the formulation of the Budget should commence around 6 months before commencement of the year to which budget is related and an enterprise will critically evaluate each activity to ascertain its need for continuity and fix limits and targets accordingly. However, evidence or workings relating to preparation the annual budget for year 2015 had not been presented to audit. Further, budgeted cash flow and budgeted capital expenditure had not been prepared for the year 2015.



## 6. Systems and Controls

Weaknesses observed in system 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.

<b>Areas of Control</b>	<b>Observations</b>
(a) Accounting	i) No proper approval procedure for journal vouchers was established by the Bank. Authorization of all journal entries was done by the Senior Manger Finance without any limit which was indicated as lack of internal controls of the Bank.  ii) Error postings had not been rectified timely manner and uncorrected error posting were observed for a longer periods in the ledger. Further, errors observed in data migrating from old system to new system were not rectified till end of the year 2015.
(b) Maintenance of Manuals	Operational Manual of the Bank had not been updated since 2013 to reflect the current status.
(c) Corporate Governance	The Bank needs to comply with the directions in Corporate Governance and instructions given by the Central Bank of Sri Lanka relating to the areas of non-compliance.
(d) Loan Administration	Actions should be taken to minimize the risks arising from non performing loans by implementing efficient recovery actions.