

National Savings Bank - 2017

The audit of financial statements of the National Savings Bank (“the Bank”), and the consolidated financial statements of the Bank, and its Subsidiary (“Group”) for the year ended 31 December 2017, comprising the statement of financial position as at 31 December 2017 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 read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 37 of the National Savings Bank Act No. 30 of 1971.

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

1.2 Board’s Responsibility for the Financial Statements

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

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 Auditing 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 the 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 - Bank

In my opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Opinion - Group

In my opinion the consolidated financial statements give a true and fair view of the financial position of the Bank and its Subsidiary as at 31 December 2017 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

2.2.1 Compliance with Sri Lanka Accounting Standards (LKAS/SLFRS)

The work in progress relating to building as at 31 December 2017 was Rs. 186.1 million and out of that an amount of Rs.35.23 million representing the capital expenditure incurred on construction of 18 storied building which construction works had been abandoned. The cost incurred for above construction works had not been derecognized in terms of LKAS 16. Further, the expenditure incurred thereon had become a fruitless expenditure.

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) Fraudulent withdrawals aggregating Rs.94.7 million were recorded and shown as outstanding balance as at 31 December 2017 and out of this balance, a sum of Rs.59.9 million and Rs.11.2 million had remained outstanding for more than one year and 05 years respectively without being cleared.
- (b) Insurance claims receivable on pawning advance amounting to Rs. 36,621,757 shown as other assets had not been recovered even up to 31 December 2017.

2.4 Non – Compliance with Laws, Rules, Regulations and Management Decisions

Instances of non-compliance observed with the following Laws, Rules, Regulations and Management Decisions are given below.

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

Non compliance

National Savings Bank Act, No.30
of 1971

(i) Section 47

Deposits which are inoperative over 10 years should be transferred to Unclaimed Deposit Reserves Account. However, it was observed that such deposits totaling Rs.975.27 million were remained as dormant in the financial statements as at 31 December 2017 without transferring to the said reserves account.

(ii) Section 47(4)

Payments made to customers from the Unclaimed Deoposit Reserves Account shall be paid as soon as possible by the Secretary to the General Treasury out of the Cosolidated Fund to the Bank. Although the Bank had paid Rs. 275.42 million during the period from 2012-2017, the Secretary to the General Treasury had not reimbursed the aforesaid amount to the Bank.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Bank during the year under review had resulted in a pre-tax net profit of Rs. 14,029 million as compared with the corresponding pre-tax net profit of Rs. 13,303 million for the preceding year, thus indicating an improvement of Rs. 726 million or 5.46 per cent in financial results for the year under review. Increase in interest income and gain from trading was the main reason attributed for this improvement 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.539 million as compared with the corresponding pre-tax net profit of Rs 109 million in the preceding year, thus indicating an improvement of Rs. 430 million or 394 per cent in the financial results. Increase of net gain from financial instruments through fair value by Rs. 412 million or 422 per cent was the main reason attributed for this improvement in the financial results.

The value addition of the Bank had gradually increased from Rs.7,447 million in the year 2013 to Rs. 24,834 million in the year 2017 after taking into account the personal emoluments, depreciation and taxes paid and payable to the Government aggregating Rs.8,336 million for the year under review and total value addition of the Bank had increased by Rs.2,170 million or 9.6 per cent as compared with the previous year.

The overall income of the Bank for the year under review was Rs.107,817 million and as compared with that of the preceding year overall income of Rs. 87,399 million, it was showing an increase of Rs.20,418 million or 23.3 per cent.

3.2 Analytical Financial Review

The following observations are made.

(a) **Profitability of the Branches**

The pre- tax net profit of 235 Branches and 02 Divisions of the Bank was aggregating Rs.18,815 million while losses aggregating Rs. 1,292 million were reported from 18 Branches, Head Office and two Divisions of the Bank during the year under review.

(b) **Significant Accounting Ratios**

According to the information made available, certain important ratios of the Bank for the year under review and the preceding year together with Sector Ratios are given below.

	Sector Ratio*	2017	2016
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	As a percentage		
<u>Profitability Ratios</u>			
Return on Average Shareholder's Funds (ROE)	19.2	26.52	29.37
Return on Average Assets (ROA)	1.5	1.46	1.5
Net Interest Margin	3.2	2.7	2.98
<u>Capital Adequacy Ratios</u>			
Core Capital Adequacy Ratio- Tier I (Minimum 6.25 per cent)	12.8	11.93	11.31
Total Capital Adequacy Ratio (Minimum 11.75 per cent)	15.0	15.31	13.86
<u>Liquidity Ratios</u>			
Liquidity Asset Ratio	61.6	73.4	72.6

* Sector ratios were extracted from the information published by the Central Bank of Sri Lanka.

The following observations are made in this connection.

- (i) Return on Average Equity (ROE) of the Bank in the year 2017 had been decreased by 2.85 per cent as compared with previous year. However, it was higher than the sector ratio for the year 2017.
- (ii) It was revealed that the Bank has maintained unnecessary liquidity assets as the liquidity ratio is much higher than the sector ratio of 61.6 per cent.

(iii) Although the core capital adequacy ratio and total capital adequacy ratio of the Bank has decreased by 0.6 per cent and 0.82 per cent respectively as at the end of the year 2017, these ratios were above the minimum requirement of the Central Bank of Sri Lanka.

3.3 Legal cases initiated against the Bank and by the Bank

According to the information made available to audit, the Bank had instituted 28 legal cases against the outsiders in the District Courts and out of that 4 cases were initiated to recover the loan amount of Rs.17,298,058 from the third parties. In the meantime, two outsiders had filed the legal cases against the Bank by claiming Rs. 4,000,000. Further, the employees of the Bank had filed 52 cases at Human Right Commission, Labour Tribunal and Industrial Court against the Bank.

4. Operating Review

4.1 Performance of the Bank

4.1.1 Market Share of the Bank

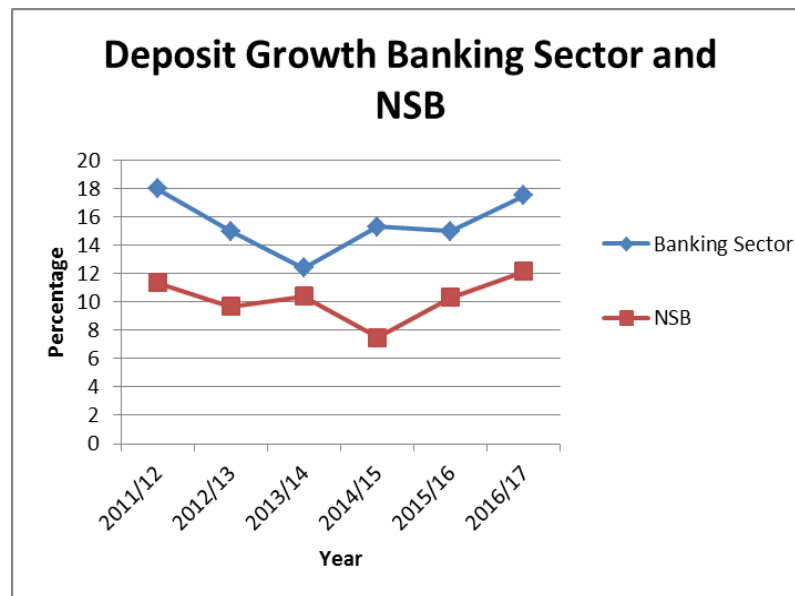
The assets and deposits base market share of the Bank during the year under review and previous 05 years as compared with the Banking Sector and Licensed Specialized Banking Sector is given below.

Market Share

Year	Asset Base		Deposit Base	
	As compared with the Banking Sector	As compared with Licensed Specialized Banking Sector	As compared with the Banking Sector	As compared with Licensed Specialized Banking Sector
	Percentage	Percentage	Percentage	Percentage
2017	9.83	74.08	9.96	75.64
2016	10.07	75.77	10.44	77.67
2015	10.50	76.39	11.03	77.97
2014	11.18	71.68	11.82	78.07
2013	11.01	71.18	12.04	81.33
2012	10.00	68.64	12.62	81.13

The following observations are made in this regard.

- (i) The average assets base market share of the Bank is around 9.83 per cent as compared with Banking Sector while it was around 74.08 per cent as compared with Licensed Specialized Banking Sector.
- (ii) According to the above information it was revealed that the deposit base market share of the Bank in the banking industry had continuously deteriorated from 13.38 per cent in 2011 to 9.96 per cent in 2017 by 3.42 per cent despite the fact that Bank is fully owned by the Government and maintained “AAA” under Fitch rating for the last several years.
- (iii) Market share position of the Bank in terms of total deposits in the Licensed Specialized Banking Sector stood above 75 per cent though it had reported a declining trend after the year 2013.
- (iv) The Year on Year growth (YOY) in the deposit base of the Bank and Banking Sector is depicted in the following graph.



Accordingly, it was observed that Bank’s YOY growth was below the growth of the banking sector during the period under concern which would be the less achievement of the object as stipulated in the Act.

4.1.2 Establishment of Savings Points

According to the information made available, the performance of the establishment of the savings points of the Bank during the year under review as compared with the preceding year is given below.

	<u>2017</u>	<u>2016</u>
Number of Branches	253	250
Number of Account Holders (Mn)	19,898	19,285
Number of ATMs	286	279
School Bank Units	2,239	2,858

According to the above information, the Bank had established 3 new Branches during the year 2017. However, 619 School Bank Units had been closed during the year. Though the number of account holders had improved by 613,000 in the year 2017, its savings had improved only by 12 per cent in the year 2017 as compared with the previous year. However, Licensed Specialized Banking Sector had achieved 15 per cent improvement during the period under concern.

4.2 Loan Administration

4.2.1 Non-performing Loans

The following observations are made.

- (a) The total outstanding loan balances as at 31 December 2017 was Rs. 299,304 million and out of that Rs.4,987 million or 1.7 per cent shown as non-performing loan balances as at that date and this were Rs.280,718 million and Rs.4,774 million in the years 2016 and 2015. Further, out of non-performing loan balances as at 31 December 2017, a sum of Rs.314.08 million or 6.3 per cent was remained outstanding for more than 3 years.
- (b) Housing loans and "Rata Ithuru loans," of Rs.94.96 million and Rs. 3.65 million respectively which were outstanding for more than 5 years, had also been included in the above non-performing loan balances.
- (c) Out of total non-performing loans, a sum of Rs.410.69 million or 8 per cent represented the non-performing pawning advances. Further, more than 78 per cent of non-performing pawning advances were in non-performing category between one to three years.
- (d) The following deficiencies were observed during the course of audit with regard to a particular personal loan of Rs. 900,000 given on 11 May 2012.
 - i. As the file containing the original documents of this loan was misplaced, a temporary debt file had been presented for audit. .
 - ii. Only two installments had been recovered from this loan as at 31 December 2017 and the total outstanding as at 20 September 2017 was Rs. 1,865,679.
 - iii. No investigation was carried out for the officer in charge of the loan file regarding the misplacement of the file.
 - iv. No legal action had been taken to recover loans as per Section 8 and 9 of the Loans Recovery Policy of the Bank or from Guarantors.

4.3 Transactions of Contentious Nature

The Bank had incurred an amount of Rs. 25.6 million for the construction of buildings in two lands without being obtained the legal ownership of the lands to the Bank.

4.4 Transactions of Apparent Fraudulent Nature

Total amount of the fraudulent nature transactions of the Bank as at the end of the year 2017 was Rs. 94,748,200 and in 26 instances the officers of the Bank have been directly involved with the transactions worth Rs 47,299,260. Further, out of total fraudulent nature transactions, a sum of Rs 18,319,191 or 19 per cent is related with the pawning articles at six Branches and a sum of Rs 42,984,600 was related to fraudulent withdrawals through Automatic Teller Machines.

4.5 Investments in Shares

The following observations are made

- (a) The overall investments in shares of 43 quoted companies as at 31 December 2017 amounted to Rs.6,249,271,030. The market value of the investments made in 32 companies amounting to Rs. 4,350,499,429 had diminished in value by Rs. 1,449,079,468 or 31 per cent as at 31 December 2017.
- (b) Return on investments made in Sri Lanka Telecom and Hatton National Bank PLC amounting to Rs. 445,642,518 and Rs. 1,655,815,624 respectively had represented lower rate of 2.37 per cent and 4.8 per cent respectively for the year 2017. *The Chairman had informed me in this regard that, " Investments available for sale (AFS) are made in view of long term benefits. Hence evaluation of these shares should be based on the profitability of these investments for a minimum period of five years."*
- (c) Dividend on investments of Rs. 870,476,421 made in 9 Companies had not been received for the year 2017.
- (d) A loss of Rs.56,377,578 had been sustained by the Bank in sales of investments made in share capital of quoted companies in the year under review.

4.6 Un-economic Transactions

A sum of Rs.35.23 million had been spent since 2008 to build 18 storied building for the Head Office of the Bank. This had been shown in the work in progress as at 31 December 2017 without any construction carried out during the previous years since this area is vested under high security zone. Therefore, the amount incurred thereon could be treated as a fruitless expenditure.

4.7 Progress of Disciplinary actions against the employees of the Bank

Even though it was decided to recover the cash fraud of Rs. 8,973,750 from the employee who had involved in the cash fraud at Badulla Branch, only Rs. 2.5 million had been recovered as at the end of the year under review. Further, the same employee was also charged on the misconduct of the pawning items. However, the disciplinary actions had been stopped as the officer was dismissed from service with effect from 21 March 2013. The Bank has taken legal action to recover the total loss incurred to Bank from the said officer.

4.8 Human Resources Management

The following observations are made

- (a) The approved cadre of the Bank for the year under review was 4853 and the Bank had deployed 4469 employee which included 3947 of permanent staff and 522 of contract basis staff at the end of the year 2017. Accordingly there were 02 excess cadre and 386 vacancies existed as at 31 December 2017.
- (b) It was observed that 250 or 29 per cent vacancies are in executive grade and those posts remained vacant even as at the end of year 2017 without being filled and 02 Deputy General Managers, 11 Assistant General Managers, 16 Chief Managers, 03 Senior Managers, 71 Managers, 139 Assistant Managers and 08 Confidential Secretaries were included in the above vacant posts. Further, there were 83 vacancies in the non-staff grade as at 31 December 2017. Hence, this situation had been badly effected to the smooth operations of the Bank.
- (c) According to Paragraph 2 of Section 2.9 of the Transfer Policy (amended) Circular No.657/ 2006 dated 30 November 2006 an officer serving in any Branch/Division should not have served in one place for more than 5 years except for Specialized Divisions determined by the management. However, 21 employees serving in the Credit Division and 07 employees serving in the Supplies Division were in service of those Divisions over 7 years without adherence to the above Circular.

5. Accountability and Good Governance

5.1 Action Plan

Thirteen targets included in the Action Plan for the year under review relating to 08 Divisions such as Retail Landing, Card Centre, Corporate Finance, International Banking, Marketing, Information Technology, Premises, Research and Development had not been implemented during the year.

5.2 Internal Audit

Although the approved cadre of the Internal Audit Division was 73, the actual cadre has been only 44 officers as at the end of the year 2017. Accordingly, 36 vacant posts and 07 excess posts were remained as at 31 December 2017. Two Assistant General Managers (Internal Audit), 3 Chief Managers and 4 Senior Manager Positions were also included in the above vacant positions. 7 post of Manager (Audit) in Grade III-I and 10 post of Assistant Manager (Audit) in Grade III-II had been remained in vacant as at 31 December 2017. Though 01 post in Translator (English) included in the approved cadre, no one had been employed in the actual cadre of the Division as at 31 December 2017.

6. Un- resolved Audit Paragraphs

International Bond Issue- 2013 and 2014

According to the decision taken by the Cabinet of Ministers on 19 December 2012, it was granted the approval to issue the International Bonds worth US Dollars 1,000 million and to lend these funds to state owned infrastructure development enterprises which are capable of repaying the loans and servicing of respective loans for financing the projects. Accordingly, the Bank had issued international bonds worth US Dollars 750 million in the year 2013 and US Dollars 250 million in 2014 at an interest rate of 8.875 per cent and 5.15 per cent respectively.

The total amount of the proceeds had been invested in Treasury bonds and fixed deposits from the date of bond proceed received without disbursements of loans to state own enterprises and government own or control projects primarily in the infrastructure sector as per the Offering Memorandum. The income on investments of the bond proceeds and expenditure incurred on behalf of this bond issue during four years period up to the end of the year under review is given below.

Year	Bond Value	Total Income	Percentage	Total Expenses	Percentage
	Rs.	Rs.	%	Rs.	%
2014	32,966,250,000	917,907,255	*9.32	534,033,203	*5.42
2015	36,015,000,000	2,962,110,449	8.22	1,764,281,301	4.90
2016	37,437,500,000	3,026,575,503	8.08	1,890,383,656	5.05
2017	38,307,500,000	3,709,392,856	9.68	1,973,662,773	5.15

* Interest income/ expenses related 109 days are annualized to arrive the percentage

Accordingly, income has increased from 8.08 per cent to 9.68 per cent by 1.6 per cent in the year 2017 against the previous year and effective cost of the bond had increased by 0.1 per cent as compared with 2016.

The overall Income and Expenditure of the International Bond Issue of US\$ 1,000 million

The Bank had spent sums aggregating Rs. 46,501,738,449 as interest and other expenses in respect of the above bonds up to 31 December 2017 while earned an income of Rs. 57,833,850,952 by investing the bond proceeds during the same period. Details are as follows.

Year	Total value of the bond at the year-end according to financial statements	Total interest and other expenses	Percentage	Total interest income	Percentage
	Rs.	Rs.		Rs.	
2013	98,250,000,000	2,559,549,750	*9.06	3,153,860,053	*11.16
2014	131,865,000,000	9,248,552,817	7.01	13,155,256,934	9.98
2015	144,060,000,000	10,874,010,110	7.55	13,818,036,954	9.59
2016	149,750,000,000	11,659,635,954	7.79	13,377,696,227	8.93
2017	153,230,000,000	12,159,988,818	7.94	14,329,000,784	9.35
Total		<u>46,501,737,449</u>		<u>57,833,850,952</u>	

* Interest income/ expenses related 105 days are annualized to arrive the percentage

The following observations are also made in this connection.

- The average expenditure of the bonds stood at 7.74 per cent at the end of year 2017. Further, total expenses of the bonds as compared to the value of the bond had been increased by 0.15 per cent in the year 2017. Further, the Bank had not entered into any forward exchange rate agreement in order to buy Dollars and to repay investors when bonds get matured in the year 2018 and 2019.
- The average total income earned had decreased from 9.35 per cent to 8.93 per cent in the year 2017 as compared with the preceding year. As the average total income was 9.35 per cent and the average total expenses was 7.94 per cent, the Bank had able to yield a gain of 1.41 per cent as at the end of the year 2017.

Delays in Construction Works

Even though the construction works of four Branches had been included in Action Plan (Three Branches in year 2011 and one Branch in year 2012), the construction works of those Branches had not been completed even up to 31 December 2017. As a result, the rental amounting to Rs.11.89 million had to be paid for building obtained on rental basis in order to run these

Branches. If the construction works completed within the stipulated time period, it would have been able to save this rent payments.

Financial Facility to Weras Ganga Storm Water Drainage Project (Sri Lanka Land Reclamation and Development Corporation – (SLLRDC))

Approval of the Board of Directors had been granted for a loan facility of Rs.14,227 million for the above project at the Board meeting held on 26 June 2013. Further, the Board had granted approval to differ the interest payments due for the years 2014 and 2015 and capitalized on half yearly basis. Accordingly the loan amounting to Rs. 2,550 million had been provided in year 2014 and the total outstanding amount as at 31 December 2017 was Rs.2,802 million which comprising total disbursement of Rs.2,550 million and capitalized interest of Rs.252 million.

The following observations are also made in this regard.

- i. Although according to the loan agreement the capital repayments scheduled to be commenced with effect from 24 October 2016 with biannual installment of Rs.592.79 million, this period was extended to 23 April 2018 by the Bank.
- ii. As per the Board Credit Committee meeting held on 22 May 2018, the Committee had recommended to amend the conditions in the loan agreement by limiting the loan facility to Rs. 2,802 million and the capital repayment to be commenced with effect from 24 October 2018. However, a new agreement in this regard had not been entered into between the Bank and SLLRDC even up to 31 July 2018.

7. System and Control

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

Area of controls	Observations
Promotion of savings	Since the main objective of the Bank is promotion of savings, significant improvement in savings was not observed as compared with the improvement of the banking industry.
Maintenance of Market share	The Bank should have a plan to maintain or uplift its market share position because it was noticed that it is declined continuously.
Utilization of Dollar bond proceed	The Bank had not utilized the entire money received from the issue of bond worth US\$ 250 million which obtained to facilitate the infrastructure projects as per the Offering Memorandum since 2014.