

National Savings Bank - 2021

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the National Savings Bank (the “Bank”) and the consolidated Financial Statements of the Bank and its subsidiaries (the “Group”) for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flow for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018 and the Finance Act No. 38 of 1971.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank and the Group as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank and the Group’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Bank and the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank’s and the Group’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Bank and the Group are required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Bank and the Group.

1.4 Audit Scope

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticisms throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 and the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank and the Group's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Bank and Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible, and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Bank and the Group's, and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Bank and the Group's has complied with applicable written law, or other general or special directions issued by the governing body of the Bank.
- Whether the Bank and the Group's has performed according to its powers, functions and duties; and
- Whether the resources of the Bank and the Group's had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Audit Observations on the preparation of Financial Statements

1.5.1 Internal Control over the preparation of financial statements

Audit Issue	Management Comment	Recommendation
There is a high risk of manual intervention in the preparation of financial statements. Two main trial balances are being prepared separately for Branches and Head office. Trial balances of all branches are abstracted from CBOS system and convert it to MS excel spread sheet format and create a single Trial Balance for branches. Trial balances of head office divisions are taken separately and amalgamated in to a single TB for Head office. Finally, by using both Trial Balances, financial statements are being prepared.	Currently, Branch General Ledger and Head Office General Ledger are maintained as separate G/L systems. However, necessary controls are in place to ensure the capturing and recording of the transactions to individual G/L systems when there is a manual intervention for the transactions. All the trial balances are generated through the G/L systems and MS Excel Spread Sheets are used to prepare the Financial Statements (FS) of the Bank and relevant controls are in place to ensure the accuracy of the FS. Further, the implementation of Core Banking solution has already started to overcome the manual intervention of the current system.	Manual interventions in preparing financial statements should be minimized.

1.5.2 Unreconciled Control Accounts or Records

Audit Issue	Management Comment	Recommendation
Inter branch balance as per the financial statements as at 31 December 2021 was Rs.407,412,355. That balances as per schedule given by the Finance Division was totaling to Rs.408,813,260 aggregating several unreconciled balances. Hence a difference of Rs.1,400,905 had been observed and no any procedure had been formulated by the bank to	The following procedures are in place to reconcile the inter branch balances. <u>Manual HO Our Account</u> Reconciliation statements are being prepared by the branches on monthly basis to monitor the balances for the clearance. <u>Automated Head Office Our Accounts</u> Comparison of inter branch balances are prepared monthly basis and regular meetings are conducted to monitor the balances for the	Strong procedure should be followed by the bank to minimize the control account's balances.

reconciled these inter branch clearance including settlement accounts. accounts' balances.

The initial inter branch balance was Rs.408,813,260. However, this has reduced to Rs. 407,412,355 due to the subsequent settlement of the interbranch balance in the Financial Statements.

1.6 Accounts Receivable and Payable

1.6.1 Receivables

Audit Issue	Management Comment	Recommendation
(a) Total outstanding balance of the corporate loans as at 30 June 2022, was Rs.91,721 million and out of that, Rs.4,165 million was non-performing loans. Out of above non-performing loan balance, 95.3 per cent and 4.7 per cent had been granted to a foreign company and two private local companies respectively.	Noted the comments	Non-Performing Loan balance should be reduced.
(b) Receivable amount to the Bank from fraudulent withdrawals as at 30 June 2022 was Rs. 96.87 million. Out of that, a sum of Rs.77.97 million was coming from more than five years. Fraudulent withdrawals amounting to Rs.11.59 million related to E-commerce transactions and ATM card frauds was occurred during the years 2021 and 2022. Out of that, Rs. 3.9 million was related to Jaffna 2 nd branch.	Court case is pending for Rs.3.9Mn related to Jaffna postal fraud. An adequate provision of Rs. 88Mn has been made for the possible losses of fraudulent withdrawals. (After adjusting for the possible recoverable amount). Administration Division is continuously following up fraudulent withdrawal account and necessary actions are taken to clear the balances.	Fraudulent activities should be minimized by using strong controls.

1.7 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Non-compliance Laws, Rules Regulations etc.	Management Comment	Recommendation
(i) National Savings Deposits which are inoperative over 10 years should transfer to the (a) Section 47 "Unclaimed Deposits	Bank has transferred a sum of Rs. 1,107Mn lying in the credit of dormant accounts to the	Bank should comply with provision of the NSB Act.

Reserves account”. “Unclaimed Deposits Reserves” accounts in the year 2021. Due to the higher percentage of reactivation of Dormant Accounts by the customers transfer is made periodically (annually). The remaining balance will be considered for the next year transfer.

- (b) Section 47 (4) Payments made by the Bank to customers through the Unclaimed Deposits Reserves Account should be reimbursed from the consolidated fund of General Treasury. However, a sum of Rs.850.48 million paid to customers up to 2021 had not been reimbursed even up to the audited date of 31 August 2022.
- Requests have already been made to the Treasury and this is being followed. Bank should comply with provision of the NSB Act

(ii) Banking Act
Direction No.12 of 2007

- (a) Section 3 (1)(i)(j) The Bank has not completed the succession plan for the year 2020/21. Succession Plan has already submitted to the Board. Bank should comply with the Banking Act Directions.
- (b) Section 3 (2) (iv) Although the Board should have at least three independent non-executive directors or one third of the total number of directors, whichever is higher, only one independent non-executive director is appointed for the Board and all other six directors are non-independent and non-executive. We have informed the requirement to the appointing authority (Secretary to the Treasury). Bank should comply with the Banking Act Directions

(c) Section 3 (6) (ii) (a)	Although the Chairman of the Audit Committee is an independent non-executive director, the Chairperson of the bank's board audit committee is a non-executive and non-independent director who chairs the board audit committee of subsidiary of NSB.	We have informed the requirement to the appointing authority (Secretary to the Treasury).	Bank should comply with the Banking Act Directions.
(d)Section (6)(iv)(f)	Although the Nomination Committee shall be chaired by an independent director and preferably be constituted with a majority of independent directors, the Chairman and even the majority of the committee are non-independent directors.	Informed the requirement to Board Members and one Director resigned accordingly.	Bank should comply with the Banking Act Directions.
(iii) Public Enterprise circular No. 01/2020 of 27 January 2020	The Chairperson of the NSB has used two vehicles and 4,401.64 liters of fuel from NSB and 1,800 liters of fuel from Sri Lanka Savings Bank (SLSB) during the year 2021 by exceeding the limits of the circular.	Chairperson of the Bank participates in Bank's savings promotional campaigns and therefore travels through the branch network covering the entire island. Also, she travels to Colombo from Kandy which is her hometown. Further, Chairperson uses CAT 1972 with an engine capacity of 2982 CC which is 6 years old, and the fuel consumption is very high. The other vehicle in the pool. i.e. KU 8117 is also over 10 years old which is used by the Chairperson in case the CAT 1972 cannot be used due to service, repair	Bank should comply with the PED circulars.

and maintenance. The fuel consumption of KU 8117 is also very high.

- (iv) Public Enterprise circular No. 03/2016 of 29 April 2016
- The Bank had paid Pay As You Earn (PAYE) tax from its own funds according to the collective agreement instead of being deducted from respective employees. Payment details of last five years are as follows.
- As per the collective agreement tax on emoluments are borne by the bank.
- Bank should not pay PAYE tax on employment income of staff.

Year	Amount Rs. (Mn)
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2017	155.15
2018	157.11
2019	125.55
2020	146.79
2021	11.81

1.8 IT General Controls

Audit Issue

Management Comment

Recommendation

- (a) Although the system users should be deactivated immediately from the relevant systems when they retire or resign as per IT Security Policy and GM Circular No. 1742/2016, there were users accounts of resigned employees were not deactivated and remained active after their resignation dates until the reporting date.
- DGM-IT has instructed the HR division to inform the IT Division before 1 week ahead on the last working days of the retired/ transferred/ terminated employees.
- Bank should comply with the IT Security policy by strengthening controls.
- (b) According to the Section 3.6.2 of Information Security Policy, IT Operations, Hardware and other relevant units are required to ensure that passwords for active accounts of a departing employee or Third-Party staff are changed immediately on the departure of the employee. However, there were termination delays of the deactivation of accounts at the sample audit.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs. 22,119 million and the corresponding profit in the preceding year amounted to Rs.10,107 million. Therefore, an improvement amounting to Rs. 12,012 million of the financial result was observed. The reason for the improvement is the increase of net interest income by Rs. 19,739 million.

Total interest income of the Bank had increased by 7 per cent or from Rs. 122,512 million to Rs. 131,438 million in the year 2021 due to increase in interest income from debt and other instruments by Rs. 11,959 million or 17 per cent. Interest expenses for the year had been decreased by 12 per cent due to decreased of interest paid on due to banks and depositors by Rs.10,923 million compared with preceding year.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review compared with the preceding year with the percentage of increase or decrease are given below.

	Variance Increase/ (Decrease) (Rs. '000)	Variance %	Reason for the Variance
Net Interest Income	19,739,428	57	Increase of interest income from debt and other instruments by Rs.11,959 million
Net fee and commission income	286,972	11	Increase of fee and income generated from loan related services.
Net other operating income	291,117	(36)	Gain on revaluation of foreign exchange had rapidly decreased by Rs.186 million and dividend income had decreased by Rs.26million.
Impairment reversal for loan and other losses	587,040	(12)	Impairment provision for the loans and advances amount had been decreased by 37 per cent or Rs.1,746 million compared with previous year.
Total expenses	3,609,267	23	Salary and bonus under personal expenses had been increased by Rs.2,635 million.

2.3 Ratio Analysis

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

Description	Sector Ratio*	Bank
Profitability Ratio	2021	2020

Return on Equity (ROE)	21.5	33.92	20.15
Return on Assets (ROA)	1.7	1.93	1.24
Interest Margin	4.1	3.71	2.77
Assets Quality Ratio			
Gross Nonperforming Advances (NPL)	6.5	2.97	2.79
Capital Adequacy Ratios			
Basel III – Tier I (Minimum 8%)	12.0	18.60	13.65
Basel III – Tier I (Minimum 12%)	14.6	20.83	16.45
	52.8	59.63	69.1
Liquid Assets Ratio			

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

The following observations are made in this regard.

- (i) The return on equity (ROE) ratio and Return on Assets ratio (ROA) of the Bank had been increased by 13.25 per cent and 0.69 per cent respectively in 2021 as compared with the previous year.
- (ii) The liquidity assets ratio had decreased by 13.7 per cent in 2021 when compared with the previous year and it is above the industry average of 52.8 per cent.
- (iii) Total capital adequacy ratio of the Bank had increased by 4.38 per cent as at 31 December 2021 which is higher by 6.23 per cent than the minimum statutory requirement of 14.6 per cent.
- (iv) Net interest margin of the Bank in 2021 had increased by 0.94 per cent as compared with the previous year. However, interest margin is less than the industry average interest margin of 4.1 per cent.

3. Operational Review

3.1 Uneconomic Transactions

Audit Issue	Management Comment	Recommendation
(a) Although the Bank had rented out 4 storied building for the use of Pettah branch, two floors of the building with an extent of 4,629 square feet have remained idle without use. The Bank had paid Rs.47.55 million as rent expenses up to December 2021.	Earlier NSB Pettah Branch was located in the archbishop's building at Pettah. They requested to vacate the building immediately for renovations. But the Bank couldn't find a suitable place to shift the Branch other than this building in a hurry. Though the said building is too excessive by floor area, the building had to be rented due to the fact that entire building has single stairway to entrance for all floors. However, the Bank had negotiated with the Building Owner for the fair rent for the area that the Bank intended to use. Therefore, the Bank accepted this building as it is, with the intention of allocating the rest of two floors for the Bank's circuit or for any other useful purpose. Due to the Covid 19 outbreak and current economic crisis, the Bank couldn't implement the same.	Bank should use its assets economically.

- (b) Kottawa branch had obtained the 1st floor of the existing building at a monthly rental of Rs.200,000 for the period from August 2020 to August 2025 (5 years) and at the beginning, the Branch had paid Rs.3,600,000 as a rent advance (18 rentals). However, bank had not used that floor up to now due to delay in refurbishment.
- It has been postponed of interior works, due to budgetary constraints and present economic conditions. However, the Branch utilize that floor as their Storage without proper interior arrangement.
- Bank should use its assets economically.

3.2 Management Inefficiencies

Audit Issue

Management Comment

Recommendation

3.2.1 Staff Allowances

- (a) When the Board of Directors had taken actions to grant approval at the first time to transferring the ownership of a vehicle to DGMs of the bank at their retirement, the treasury representative had disagreed with this decision by mentioning that it would be a bad precedence to other institutions and high cost of investment for replacement and also this was rejected by the Department of Public Enterprises by the letter dated 16 September 2019 stating that State-owned Enterprises are formed using public money.
- At the above situation being so, DGM (Postal and Branch Credit) had obtained a Honda Vezel Vehicle (CAD 2302) at her retirement on 12 November 2021 after obtaining no objection letter from the General Treasury. However, both the Board and the treasury had not considered the prohibition of importation of vehicles imposed by the government since March 2020 when approving above facility.
- Subject letter dated 16.09.2019 had been received by the Bank in connection to the request made to transfer the ownership of the vehicle to the then Senior DGM.
- However, the Board granted approval to transfer the ownership of the subject vehicle as per the empowerment conveyed to the Board by the Government Treasury vide the letter dated 30.11.2021 signed by Director General of Department of Public Enterprises.
- The Board approved the transfer of vehicle to DGM Postal & Branch Credit in 2021.
- Board of directors should take economic decisions in the side of the bank and current condition of the country.

(b) Board has approved the above facility stated (a) by considering NSB as a peer bank of two banks, BOC and PB. However, NSB cannot be considered as peer state banks of above two banks since it is not a licensed commercial bank and NSB is difference with other two commercial banks due to following facts.

		NSB	PB	BOC
Total Asset		1,579	2,648	3,803
(Rs.Bn)				
Loan and Advances		539	1,937	2,577
(Rs.Bn)				
Deposits (Rs.Bn)		1,428	2,071	2,867
Value to government		3.5	16.3	20.71
(Rs.Bn)				
Branches (No)		261	742	671
Employees (No)		4616	7568	8337

Being a state bank, the salary and other benefits are considered by the NSB along with the other state banks.

When taking decision Board of directors should take economic decisions in the side of the bank and current condition of the country.

(c) Board had approved the compensatory and fuel allowances paid to DGM and above officers which is higher than the allowances proposed by the Management Committee. However, treasury representative of the Board was opposed to that decision.

Grade	Existing allowance (Rs.)	Approved allowance (Rs.)
GM	Rs.175,000+ Fuel 275 Ltr	Rs.200,000+ Fuel 275 Ltr
SDGM	Rs.150,000+ Fuel 200 Ltr	Rs.175,000+ Fuel 225 Ltr
DGM	Rs.125,000+ Fuel 225 Ltr	Rs.150,000+ Fuel 225 Ltr

In terms of section 26 (2) and (3) of the National Savings Bank Act No 30 of 1971 and its amendments, the Board can appoint officers and servants as it may consider necessary for the conduct of the business of the Bank. Further, the salaries and benefits and other conditions of service of the General Manager, other officers and servants shall be determined by the Bank. Further, as per section 2.1 a) of the BHRRC Charter prepared as per the guidelines issued by the Central Bank of Sri Lanka, the committee shall determine the remuneration policy (salaries, allowances and other financial payments) relating to Directors, Chief Executive Officer (CEO) and Key Management Personnel of the Bank, other than the

Board of directors should take economic decisions in favor of the bank.

remunerations determined by the Collective Agreement.

Accordingly, the increase of Compensatory and Fuel Allowances to Grade 1 and above staff has been recommended by BHRRC and approved by the Board of Directors.

3.2.2. Risk Management

- (a) The bank has conducted its critical business operations such as treasury, corporate loans and GL integrations without having IT systems.
- The Operational Key Risk Indicators (OKRI) dash board indicate the risk level of operations without system support. However, implementation and procurement of systems to support stated operations are in progress.
- Bank should take necessary actions to use IT systems for critical business operations.
- (b) Although the review of product, process and systems referred by operational divisions or product development committee and provision of proactive proposals to BIRMC with respect to certain functions according to the Section 2.2 (c) of part D of the Banking Act Direction No.07 of 2011 and Section 6.2 (f) of Risk Management Charter, it was not observed in audit that RMD has done the review before the introduction of new products/processes to identify the risks of being or poor performance.
1. Section 2.2 (c) of part of D of the Banking Act Direction No.07 of 2011.
- Bank should review the risk before introducing every new product and processes.
- The Bank collects operational loss events as per the General Manager's Circular No.927/596 and classify them in to 'Level 1 loss event categories' introduced by BASEL (i.e., Internal Fraud, External Fraud, employment practice and work place safety, client product and business practices, damages to physical assets, business disruption and system failures and execution delivery and process management errors)
This is reported to BIRMC via Quarterly Risk Report.
 - The same menu of operational risk events is used in categorizing risk events i.e., what could go wrong events in Risk Control Self- Assessment (RCSA) process, which is conducted to identify, assess, and manage risk at process level.

2. Section 6.2 (f)

Reporting changes in Risk Profile.
(Bank as a whole)

Quarterly Risk Report to BIRMC is the report on Risk profile of the Bank. It consists of 9 dash board reports on significant risk areas.

Reporting changes in Risk Profile –
Division and Function

1) RCSA reports submitted to the BIRMC year 2021.

1. Treasury Operation.
2. Card Centre.
3. Safe Deposit Lockers
4. Retail Credit Process.
5. Recovery Process

2) Below RCSAs are in progress for year 2022.

- a. Pawning – Submitted to ORMC.
- b. Corporate Credit Process – Submitted to ORMC.
- c. Treasury Operation – In Progress.
- d. Card Centre – In Progress.
- e. Teller Function – In Progress.
- f. E- Banking – In Progress.
- g. Supplies Division – In Progress

3) Quarterly OKRI dashboard indicates risks in critical functions.

i.e. Retail, Treasury, Corporate, HRD)

Reviews before the introduction of new products/processes

RMD provides comments to new products/ process introduce through CC/IC/ALCO and by participating on committees appointed for the process/ product changes.

(c) Though meetings should be conducted once a month according to Section 05 of the Operational Risk Management Committee

Papers were submitted to ORMC meeting on a monthly basis. ORMC meetings were held as below

Continues meetings should be conducted for effective

Charter, only 07 meetings were hold for the year 2021 as there was capability to conduct virtual meetings amidst the Covid-19.

up to the month of October in year 2022.

management of risk.

- 28 January 2022 – January Papers
- 04. April 2022 – February/March Papers
- 06 June 2022 – April/May Papers
- 29 June 2022 – June Papers
- 25 July 2022 - July Papers
- 26 August 2022 – August Papers
- 29 September 2022 - September Papers
- 31 October 2022 – October Papers

(d) Although the root cause analysis should be conducted to minimize the plausible risks in a proactive manner by identifying the lapses in internal controls and other possible causes for operational loss events and near miss events according to the section 4.1.6 of the Operational Risk Management Policy, the RMD has done only one root cause analysis for 2021.

Board of Directors at the meeting held on 21.01.2022 requested DGM – HRD to make available the information requested by the CRO for the purpose of risk analysis subject to take relevant measures to maintain the confidentially.

Bank should comply with the operational risk management policy of the bank.

Accordingly, from the information received, 6 Root Cause Analysis reports were submitted to the ORMC up to date.

After expressing the concerns on not receiving information for Root Cause Analysis, Management Committee dated on 07th October 2022 advised Audit Division to provide a synopsis of the investigation reports to RMD to continue the process of the Root Cause Analysis.

3.2.3. Loan disbursement

(a) The Bank had granted a joint property loan to two persons worth of Rs. 164,730,000. Following observations are made in this regard.

i) Bank had not done a proper evaluation to verify the income sources of loan holders with respect to recovering the said loan.

The bank had conducted a credit evaluation and the source income was rent income. The income was

Bank should evaluate the income source of the loan holder before

	verified with the registered rent agreements signed with tenants.	granting loan.
ii) At the initial stages, Board and credit committee had disagreed to granting the loan due to unfavorable status of the CRIB and the businesses. However, finally the Board had given approval to grant the above loan without considering CRIB arrears, without taking DTA policy from customers, extending the repayment period from 15 years to 20 years and by exceeding the loan to value ratio of 75 percent in a special board meeting held.	Noted. Exceeding the 75%, granting a loan for period of 20 years are in line with normal credit policy of the bank. The customer has given a written undertaking that the DTA policy will be submitted as they were not in a position to bear the cost due to the high initial expenses of obtaining the loan. However, the applicant did not honor the commitment.	Before granting an approval, board should consider the unfavorable condition of loan holder.
iii) Two Board directors including treasury representative who had rejected to give the approval to said loan had not been invited to the above-mentioned special meeting which had with the attendance of a borrower. The transparency of board decisions is questionable.	Noted the comments.	All director's opinion should be considered before taking board decision.
iv) The Borrower had paid only two installments. Total arrears of the loan as at 31 July 2022 was Rs.252,236,697 and it cannot be recovered from the total value of the property of Rs.210,000,000 as per last valuation.	iii) Two valuations were obtained at the time of granting the loan. The average of the two loans was Rs. 200Mn. The property is to be auctioned.	Strong recovery procedure should be followed by the bank.
v) The Bank had decided to waive off the penalty and early settlement fees for the request made by the borrowers in April 2022. However, they had not paid the remaining balance up to now.	iv) The customer has made a request to waive off the penalty and the early settlement fee. However, they have not paid the remaining balance.	Strong recovery procedure should be followed by the bank.
(b) The Bank had granted a syndicated loan with People's Bank (PB) to RPI Private Limited (Maldivian company) on 14 June 2018. USD 09 Million and USD 01 Million was granted by the Bank and People's Bank respectively. The borrower had not paid any capital repayments and	(i) The NSB Act permits granting syndicated loans irrespective of the purpose. This loan was granted with the approval of the Board of Directors and Central Bank of Sri Lanka. Further, Bank has been granting syndicated loans for commercial purpose	syndicated loan should be granted within the bank's objectives.

the arrears interest was USD 2.15 Mn. as at the date of audit of 16 August 2022.

Following observations were made in this regard.

prior to this. This loan was granted in 2018, and to date no such concern was raised.

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|--|---|---|
| i) Even though granting loans to foreign company for commercial purposes does not cover under the scope specified in the NSB Act, aforesaid loan was granted to a foreign company under tourism industry for the purpose of a construction. | (ii) Noted the comments. | Comprehensive credit evaluation should be conducted by the bank before granting a loan. |
| ii) No evidences were observed to prove whether the bank has done comprehensive credit evaluation or risks assessments prior to granting the loan. | (iii) Noted. The customer requested for moratoriums, and with the approval of the Board of Directors and concurrently with the other syndicated partner the bank granted moratoriums. | Bank should comply with the circulars formulated for the proper credit review. |
| iii) As per the circular no.1641/2015 on Post Loan Review Mechanism, the bank has not reviewed the credit facility within 3 months after granting the approval. | (iv) Noted. The client too had faced the same situation as that is coming under the purview of the said circular. | Before granting a loan repayment ability should be evaluated. |
| iv) The bank has granted initial grace period of one year for capital repayment from the first draw down the loan on 21 June 2018. However, the initial grace period had been extended several times for capital and interest repayment from June 2018 to June 2022 under several reason. | | Objectives of the Central bank circulars should be considered by the bank when complying with them. |
| v) Although the board of directors had granted moratorium facilities to the above project, under the circular No.5 of 2020 issued by the Central bank of Sri Lanka related to granting moratorium, the above loan is not come under the purview of aforesaid circular since the client company is a foreign company. | The client is in the process of getting the coverage.

The bank took steps to recover the | Bank should comply with the credit policy.

Bank should comply with the conditions of the loan agreement. |

- vi) Insurance coverage had not been submitted to the bank for the period after July 2021. dues from the debt service A/C.
- vii) According to the loan agreement, debt service reserve account should be opened and maintained with NSB with minimum value of USD 270,000. However, minimum balance in DSRA had not been maintained by the borrower (RPI) and current balance of that was USD 39,310 as at 21 October 2022. The bank's relied on the professional valuer's opinion irrespective of who appointed as a professional has to abide by the ethics of the respective profession. Bank should comply with the conditions of the loan agreement
- viii) According to the loan agreement, lenders should appoint a qualified expert in hotel construction as an independent project monitor to monitor the progress of the project. However, lenders had not appointed such kind of person and relied on the progress report of the chartered quantity surveyor who has been appointed by the borrower (RPI company Pvt) Ltd).

3.3 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
Although the Bank had spent Rs.83.6 million to construction activities on lands situated in Anuradhapura, Elpitiya, Galnewa, Katharagama, Kirindiwela, Moneragala, Ratnapura and Kekirawa, the legal ownership had not been taken of those lands even as at the end of the year 2021.	<ol style="list-style-type: none"> 1. Monaragala – Bank signed the Long-Term Lease and Final Agreement yet to be received 2. Kirindiwela – Bank signed the Long-Term Lease and Final Agreement yet to be received. 3. Kekirawa – reminder sent on 22.10.2021 4. Anuradhapura – reminder sent on 23.11.2021 5. Elpitiya –reminder sent on 22.10.2021 6. Galnewa – reminder sent on 22.10.2021 7. Kataragama – Bank signed the Long-Term Lease and Final Agreement yet to be received 8. Ratnapura – Bank signed the Long- Term Lease and Final Agreement yet to be received 	Immediate actions should be taken to obtain Lease agreements related to those lands.

3.4 Idle or underutilized Property, Plant and Equipment

Audit Issue	Management Comment	Recommendation
Bank had taken a land with an extent of 38.8 perches from 2008 from Urban Development Authority for 50 years period. Although the management had decided to develop a new building in that land, any construction activities had not yet been started.	Bank was instructed by the Urban Development Authority (UDA), not to engage in any permanent developments on this land since they wanted to switch the same with the Cooper's Lane Land which is adjoining to Bank's Head Office with intention of allocate land slots for the encroachers of the Cooper's Lane Land who demanded alternative land from the Kollupitiya area in lieu of existing properties.	Bank should use the land for specific purpose.

3.5 Human Resources Management

Audit Issue	Management Comment	Recommendation
(a) At the end of the year 2021, out of the board approved cadre of 5,408 there were 835 vacancies in the bank and 29 unapproved excess cadre.	(a) (i) The Bank has already filled the vacancies for the posts of Deputy General Manager, Asst. General Manager & Chief Manager.	Vacancies of the bank should be filled within reasonable time period.
i) Out of the 2,477 of executive staff cadre, 659 or 26 per cent were vacant which includes 01 Deputy General Manager, 7 Assistant General Managers, 28 Chief Managers, 15 Senior Managers, 39 Managers, and 52 Assistant Managers.	Further, the applications have already been called for promotion to Snr. Manager, Manager and the interviews for the said promotions will be conducted.	
ii) There were 29 excess posts in the actual cadre which has not been approved by the Board of Directors.	-Excess vacancies for the post of AGM (Engineering) will be addressed when reviewing the Manpower plan. -Since Mr. M.C.Rajaksha, AGM (IT) has retired from the Bank's service from September 2022, there is no excess post for the same. -Staff transfers are in progress in line with the promotion to Gr. I and accordingly the excess staff in Gr. I (Risk Management) will be placed to	Bank should recruit staff within the approved cadre and should not recruit excess cadre.

Name of the Position	Number of positions
AGM (Engineering)	01
AGM (IT)	01
Grade I (Risk Management)	01
Grade I Non-banking	02

Grade III-I Non-banking	02
Grade III-I Banking	18
Grade III-II Non-Banking	04

fill a vacancy with the aforesaid transfers.

- 2 excess staff in Gr.III-I non-banking will be considered when granting promotions to Gr. II.

- As mentioned in the table, 18 excess positions are for Gr. III-II (banking) and not for Gr. III-I (banking). Those excess positions will also be considered when granting promotions to Gr. III-I.

- iii) Out of the approved cadre (1586), 498 number of vacancies were existed as at the end of the year in grade III-III and Grade IV under supervisory designation. The interviews have already been commenced for Gr. IV and relevant vacancies will be filled after finalizing the interview process. Vacancies of the bank should be filled within reasonable time period.
- iv) The non-executive posts of Grade V and VI were 42 per cent of the total approved cadre as at 31 December 2021. Out of the actual cadre of 2,144 including 53 contract basis employees, 122 number of posts were vacant. The Bank has already called applications for the post of Staff Asst. I and the written examination for the said post to be conducted. Vacancies of the bank should be filled within reasonable time period.
- v) Bank had employed 65 number of employees on contract basis (53 under grade VI and 12 under grade VII) at the end of year without recruiting formal recruitments. Employing people on contract basis may leads to informal recruitments. With the approval of the Board of Directors the Bank absorbed the contract employees subsequent to a job test and those employees are absorbed into the permanent cadre subject to a probationary period and they will be confirmed based on performance evaluation. Without deploying staff under contract basis , staff recruitments should be made in a formal manner periodically.
- (b) The Bank has recruited the Chief Legal Officer (DGM Grade) contrary to the general recruitment procedure of the Bank by offering unreasonable benefits such as removal of probation period, placing the salary scale above the initial step, non- Board of Directors at its meeting held on 31.03.2021 granted approval to recruit Ms.K.D.Jayathilaka to the post of Chief Legal Officer (DGM – Legal) w.e.f. 01.07.2021. staff should be recruited under mentioned criteria in the approved pre designed formal Scheme of

verification of original certificates and provision of six months extension to assume duties at the request of applicant to the said officer.

More potential applicants had been limited by eligibility criteria set for the work experience in legal field and age limits.

However, Ms. Jayathilaka had declined to accept the post as she was not agreeable to the salary offered by the Bank as she was the only eligible candidate with the experience required by the Bank. The BODs at its meeting held on 8.4.2021 has informed to negotiate with Ms Jayathilake. Accordingly, she had agreed to accept the post with the following terms and conditions which has been approved by the BODs on 21.04.2021.

- Absorbed into the permanent cadre without a probation period.
 - Assumed duties subsequent to 3 months period
 - Submitting the certified copies instead of originals
- Place her on the DGM salary scale by granting 8 increments

When the Bank is recruiting from outside for specialized positions the applicants usually bargain for privileges and the BOD is empowered to decide on the salary step.

Accordingly, BOD has taken decisions as per the authority vested in terms of the NSB Act in order to appoint a suitably qualified person for the said post.

recruitment (SOR). SOR should not be changed time to time.

4. Accountability and Good Governance

4.1 Corporate Plan

Audit Issue	Management Comment	Recommendation
Although it has been taken more than 06 years so far, the Bank has failed to complete the	The Bank commenced the procurement process for the procurement of a core banking solution in April 2016 and the procurement process was	Technological application like Cor-banking system

Core banking Solution Project that initiated since April 2016 at an estimated cost of US\$ 12,446,130 without taxes and Rs.807,397,294 had been spent so far. Thus, it was not practical to spend such a longer time period to implement this kind of highly technological applications which resulting an obsolete system at the end amidst the other banks in the industry are embracing the latest technologies constantly.

completed in April 2019 with the approval of the Cabinet of Ministers to award the tender to Temenos AG/Temenos Headquarters SA. The procurement process was comprised of two main stages i.e. calling for Expression of Interest (EOI) and issuing Request for Proposal (RFP) for pre-qualified bidders. Accordingly, calling for EOI and evaluation of proposals received, and short listing of bidder was completed by March 2017 and RFP was issued to pre-qualified bidders. However, due to the complex nature of the procurement it took more time than expected for evaluation of Bids submitted by the short-listed bidders which include the site visits as well.

should be completed within reasonable time period.

The core banking system implementation Project was commenced only from October 2019 and after completion of business requirements gathering workshops, the consultants of main implementation partner left the country due to COVID-19 pandemic and they could not return to Sri Lanka until September 2021 due to international travel restrictions which directly impacted the delay in completion of project activities. Further, additional time has to be allocated due to inclusion of Loan Origination and some other modules as per the requirements of the Bank and change of rollout approach from 5 Branches to Big Bang approach.

Initial estimated time frame for the implementation of core banking solution was 18-24 months and according to the initial Master Project Plan, the Project was to be completed in 2nd quarter of 2021.

In view of minimizing the impact on project timelines due to COVID-19 pandemic and other changes, the Project activities are now being carried out simultaneously. Accordingly, design, build and testing activities are being carried out in parallel. The requirement gathering stage has been completed and design and build part of most of the modules have been completed except for Retail Lending related modules.

The Master Project Plan has been revised to incorporate the impact of COVID-19 pandemic and scope changes and delays due to unrest

situation in the country from April to August 2022 and according to the rebase line Master Project Plan, T24 Transact core banking system is expected go-live by the end of March 2023.

Further, the Bank is implementing the latest version of the core banking solution at the time of finalization of business requirements i.e. in 2021. Therefore, latest functions and capabilities of the core banking system are available for the Bank.

4.2 Internal Audit

Audit Issue	Management Comment	Recommendation
<p>The approved cadre of the Internal Audit Division was 63 employees and the actual cadre was 48. Accordingly, 15 vacant posts were observed. Further out of total approved 10 Trainees, 2 were vacant as at 31 December 2021. One post of Grade I, two posts each of Grade III-I and III-II, five posts of Grade III-III of executive are included in the above vacant positions.</p>	<p>The Board of Directors granted approval to deploy maximum of 10 Audit Trainees to the Audit & Vigilance Division. Accordingly, vacancies arise for Audit Trainees from time to time as they are completing relevant training period and due to the resignations.</p> <p>Accordingly, placing suitable trainees are continually carried on based on the vacancies. Vacancy for the post in Gr. I has already been filled by promotion to Gr. I and other vacancies also will be filled through the relevant promotions. Vacancies for the post of Executive will be filled through external recruitments for post of Officer Trainee.</p>	<p>Internal audit division should be strengthened by recruiting required staff on time.</p>