

NSB Fund Management Company Limited - 2022

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the NSB Fund Management Company Limited (“Company”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the statement of comprehensive income, statement of changes in equity and cash flow statement 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. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2022, 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 Company’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 Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is 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 Company.

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 scepticism 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 Company'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 Company'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 Company 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 Company, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
 - Whether the Company has performed according to its powers, functions and duties; and
 - Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Accounts Receivable and Payable

1.5.1 Receivables

Audit Issue	Management Comment	Recommendation
Out of the total receivable balance of Rs.246,939,587 which is receivable from General Treasury in relation to the appointment of the Company as the lead manager for the reorientation of Sri Lanka Airlines Project in year 2016, an amount of Rs.88,939,587 which is equivalent to 36 percent of the total receivable balance, is remained outstanding since 2016.	NSB FMC has made number of requests so far. The latest request was sent on 15.12.2022. With crisis faced by Sri Lanka, the receipt of funds will be delayed further. Therefore, we have taken the balance for impairment calculation as well and requested to issue a bond instead.	It is recommended for the Company to take necessary steps to recover the due amount without further delay.

1.6 Related Parties and Related Party Transactions not disclosed

Audit Issue	Management Comment	Recommendation
The Company had failed to disclose all the related party disclosures such as transactions related to Key Management Personnel of the Company and the National Savings Bank and transactions of fellow subsidiary of Sri Lanka Savings Bank Limited, as per paragraph 13 – 19 of LKAS 24, Related Party Disclosures. It was observed that there was no proper mechanism to identify the related party transactions of the company.	NSB FMC has disclosed all the Related Party transactions in the Note No. 36 of the final Accounts.	The Company should disclose all the related party transactions as per the requirement of the Standard.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
a. Section 17(d) of Circular No. 01 of 2021 - Consolidated Operating Instructions on Market Operations	The Company had to pay total amount of Rs.22,272,152 as penalties to the Central Bank of Sri Lanka due to the dishonor and failure to settle the transactions on Standing Loan Facility (SLF).	The Company has to pay Rs.16,127,826 as penalties.Due to Interest Rate hike in the market from April 2022 with the increase of policy interest rates of the Central Bank, the values of the securities that the Company had were decreased leading to available holding of free securities value come down. On the other hand, the market liquidity was reported a negative value though out the period. As a result, the company had to fulfill its borrowing from the Central Bank on overnight basis. Advises have been already given to the Senior Officers in the Back Office for better utilization of the securities and compliance with the settlement time. A monitoring mechanism has been implemented through middle office for effective use of ILF and appropriate action will be taken on timely basis.	The Company should comply with thestipulated directions ofCBSL andconduct the operations of the company in more responsible manner.
b. Section 11.2 of Volume 03 of Lanka Settlement Systems Rules Version 2.2	The Company had to pay total amount of Rs.243,830,060 as penalties to the Central Bank of Sri Lanka due to obtaining Intra-day Loan Facility (ILF) using custodian securities and securities allocate for customer repo.	Same as comment given in the item No. 1.7.a	The Company should comply with the stipulated directionsof CBSL and conduct the operations of the company in more responsible manner.

- c. CBSL Direction No. 01 of 2021 dated 09 July 2021
- The Company has failed to maintain the minimum capital requirement of Rs.2million until 31 December 2022 in several instances during the year under review.
- The NSB FMC had taken steps to reduce its portfolio with a loss expecting increase in the market interest rate to avoid the further losses. However, with larger policy rate hike in the April and market rate increase par with this, the company had to sell its portfolio at loss to avoid making further losses and due to reduction of the fair value of the portfolio mark to market losses also arisen. Therefore, both, realized and unrealized losses were booked, and the Retained Earnings was deteriorated. Further, as per the Government Decision to charge surcharge tax on previous year profit (2020), the Company had to pay Rs. 260.8 Mn as a cash tax (due parent Bank liable for the same). This impact was charged to the retain earning of the Company.
- It is recommended to make every endeavor to maintain the minimum capital requirement as stipulated in the CBSL Directions.
- However, with capital infusion of NSB and reported net profit for the month of December 2022, the Company recorded Rs. 2,946 Mn of available capital as at 31.12.2022.
- d. Section 4.7 and 4.8 of Directions No. 01 of 2019 dated 20 December 2019 under the caption of the Registered Stock and Securities Ordinance and Local Treasury Bills Ordinance
- In the event of the market value securities falling below the repurchase value/ resale value of the securities at any time prior to the maturity of the transaction, a Direct Dealer Participant DDP shall allocate/ obtain additional eligible securities for the said transaction or settle part of the transaction in
- This was mainly due to the sudden increase in the rates in April 2022. To manage the shortfall, NSB FMC has obtained a Clean Borrowing from the NSB to maintain the adequate securities with hand. The outright repo borrowing (overnight and term repos) have reduced to manage the available securities.
- The Company should comply with the provisions stipulated in the relevant Acts.
- Monthly wise borrowing position Sensitivity analysis is

cash/ obtain cash for carried out and stand by funding partial settlement of the arrangement with a commercial transaction prior to the bank is under negotiation to closure of the Lanka manage any adverse impact. Settle System on the relevant day, to the extent required to ensure that the total market value of eligible securities adequately covers the said maturity value of the repurchase/ reverse repurchase transaction. However, the Company has failed to comply with the said requirement in several instances.

1.8 IT General Controls

Audit Issue

As the Treasury System of the Company has not been connected to the NSB Server, the Company has to perform its backup procedure manually. Thus, there may be high probability of having human errors and recovery issues resulting high risk of data accuracy.

Management Comment

The existing system is not a web based system; therefore back up procedure is followed. Until go for the new system, there is no alternative.

Recommendation

It is recommended to automate the backup procedure of the Company in order to ensure data accuracy and availability.

2. Financial Review

2.1 Financial Result

The net loss of the year under review amounted to Rs.2,025,825,745 and the corresponding profit in the preceding year amounted to Rs.6,049,077. Therefore, a deterioration amounting to Rs. 2,031,874,822 of the financial result was observed. The reasons for the deterioration are increase in borrowing cost, penalty paid for violation of CBSL Directions, increase in market interest rates and sale of low yield bonds at losses which resulting net trading loss of Rs.2,518,396,414.

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 is as follows;

Description	Variance – Favorable/ (Unfavorable) (Rs.)	Variance (%)	Reasons for Variance
Interest Income	899,007,129	62	Increased in interest rates.
Net Interest Income	(554,062,944)	(91)	Increased in borrowing cost and obtaining contingency loan from the parent.
Fee & Commission Income	(29,259,223)	(59)	Suspension of NSB custodian fee and termination of some trustee agreements.
Net Trading Gain/ (Loss) from Financial Instruments at FVTPL	(1,903,010,935)	(309)	Increased in the market interest rates and sale of low yield bonds at loss to minimize further losses.
Personnel Costs	6,824,667	17	Revision of salaries of the permanent staff.
Other Expenses	267,621,403	984	Increased in Bloomberg charges and SWIFT charges due to increase in exchange rates. Payment of penalty charges of Rs.259,957,886 for the violations of CBSL Directions.

2.3 Ratio Analysis

The following observations are made in some important accounting ratios of the Company for the year under review as compared with the sector ratios.

Description	Sector		Company	
	2022	2021	2022	2021
Return on Equity (%)	11.4	(2.5)	(54.5)	0.17
Return on Asset (%)	3	(0.7)	(18.6)	(0.13)
Risk Weighted Capital Adequacy Ratio – (Minimum Requirement - 10%)	23.2	42.8	36.7	22.36

3. Operational Review

3.1 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
A Management Committee has been established to strengthen the corporate governance structure and obtain the expertise knowledge of the senior management of the bank to enhance the operations, policies and procedures of the Company and also expected to be operated at a supervisory capacity. However no any management committee meetings had been conducted for the year 2022.	A Board paper has been submitted to dissolve the Management Committee as its purposes are fulfilled with ALCO meetings.	The Company should establish sub committees to the Board where applicable in a manner that ensures the smooth functioning of the company.

3.2 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
a. Although all the deal tickets should have numbered in a serial order and be authorized by respective officers as per the approved Operational Manual, there were some instances where the company was unable to complied with.	All the deal tickets are entered into the fixing solution in an order of serial numbers and respective officers in the middle office and the back office are authorizing the deals accordingly as per the operation manual. Manual deal tickets are generating for the MIS purposes accompanied by the respective VTR for the deal confirmation. Accordingly, please note the below points, <ol style="list-style-type: none">Customer deals are generated based on the application and the deal tickets are only generated for the profit calculation purpose. Therefore, no authorization is needed. (Eg. CusInv2022080043/44/45)Chief Dealer has the authority to authorize the deal tickets.In some cases, there were cases where approving authority was on leave. However, we noted the discrepancy and will take necessary precaution to avoid this in the future cases. Additionally, with the implementation of the new system manual deal ticket generation part can be excluded from the process.	The Company should comply with the provisions of the Operational Manual.

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| b. | The Company had not assigned a daily audit officer to verify the routine transactions of government securities in order to avoid the non-compliance and risks encountered with the transactions. | The Middle Office of the company monitors the most transactions of Government Securities on daily basis. With the approval of the Board of Directors, we will take steps to assign an officer from the Bank on secondment basis. | The Company should assign a daily audit officer in order to mitigate the risks involved. |
| c. | The Company has failed to take immediate actions to collect funds of Rs.5,500,000 related to a customer who has deposited money in NSB Head Office Branch on 29 April 2022 for buying treasury bills. After 10 months elapsed from the date of transaction, NSB branch had remitted the amount on 07 March 2023 based on the instructions received from the Company. It was observed that the company was unable to maintain proper internal controls over fund management of the Company. | With the interest rate increase, the customers' interest also increased to invest in Government securities. Therefore, numbers of customers from NSB branches were engaged in investments and sends funds and applications through branches without visiting NSB FMC. The workload from the customer investments from April 2022 was difficult to manage. Funds were transferred by the Head Office branch as bulks and unable to reconcile. However, it has taken long time by the HOB to confirm the balance transfer funds. The receipts of the customer funds are monitoring properly and reconcile daily now. | The Company should maintain proper internal controls for fund management and facing unexpected circumstances in the business operations under risk management framework. |

3.3 Delays in Projects or Capital Work

Audit Issue	Management Comment	Recommendation
The Company had entered in to an agreement with an Indian Company (Credence Analytics Company in India) to establish new treasury management system. Even though the company agreed to hand over the system on or before 31 December 2022, the Company was unable to hand over the system before due date.	NSB-FMC has migrated data as of 30.09.2022, now staff of the company enter transactions to system and identify issues and areas required further developments. Credence team also in the process of developing the system. However, there are few points which are essential to clear before "Go Live".	The Company should bring the new treasury management system into effective operation by overcoming unnecessary delays.

3.4 Human Resources Management

Audit Issue	Management Comment	Recommendation
a. There is no designated officer for performing human resource management functions of the Company.	NSB FMC has appointed a Chief Manager from NSB on secondment basis w.e.f. 15.05.2023 and he will overlook the HR function of the Company.	The Company should recruit or assign an officer for HR functions.
b. The Company does not have a Scheme of Recruitment (SOR) for employees which include cadre positions, responsibilities, educational and professional qualifications, other qualifications and experience, methods of recruitment and promotion, etc.	NSB FMC has prepared a SOR and already submitted for the approval of the Board.	An approved Scheme of Recruitment (SOR) for employees should be made available for the company.

4. Accountability and Good Governance

4.1 Annual Action Plan

Audit Issue	Management Comment	Recommendation
a. As per the annual action plan, though the Company has planned to introduce a Mobile App for customer convenience in the year 2019, the Company was unable to bring it into effective operation up to the date of audit on 31 March 2023.	Even though the Action Plan is prepared for three years, the Company prepares it annually. Accordingly, the latest action plan for the review of the audit is 2022. We have not included it in Action Plan 2022.	Annual Action Plan should be prepared in a prudent manner with achievable targets.
b. Although it was planned to establish a research and development unit in the year 2020, the Company was unable to establish that unit up to the date of audit on 31 March 2023.	Even though the Action Plan is prepared for three years, the Company prepares it annually. Accordingly, the latest action plan for the review of the audit is 2022. We have not included it in Action Plan 2022.	Annual Action Plan should be prepared in a prudent manner with achievable targets.

4.2 Internal Audit

Audit Issue

The internal audit function of the Company has outsourced to a private audit firm for a monthly fee of Rs.1,815,397 and it was agreed to submit quarterly reports until 30 June 2022 and monthly audit reports thereafter. However, no any finalized internal audit report was issued for the year 2022 and even up to the date of audit on 31 March 2023. Therefore, it was observed that the Company was unable to identify the internal control weaknesses in a timely manner and effectiveness of the internal audit function is questionable.

Management Comment

Internal Audit for the 2022 has completed up to October 2022 and completed for the months of January, February, and March 2023 also.

Recommendation

It is recommended to ensure the smooth functioning of internal audit in order to overcome the internal control lapses of the Company.

4.3 Audit Committee

Audit Issue

Although it was required to conduct minimum 04 Board Audit Committee meetings for a particular year as per respective Audit Committee Charter, only 02 meetings had been conducted for the year 2022.

Management Comment

Delay in receiving audit reports caused to this and therefore no reports to submit to the BAC.

Recommendation

Board Audit Committee should conduct meetings as required in order to implement the functions stated in the Audit Committee Charter.