

People's Bank and its subsidiaries - 2022

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the People's Bank (the "Bank") and the Consolidated Financial Statements of the Bank and its Subsidiaries (the "Group") for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows 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.

The Bank has been exempted from the provisions of Part II of the Finance Act, No. 38 of 1971 by an Order of then Minister of Finance published in the Government Gazette No. 715 of 14 May 1992 by virtue of powers vested in him by Section 5(1) of the said Finance Act.

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 2022 and of their financial performance and their 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 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 intends to liquidate 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 Group 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 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 skepticism 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 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 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 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 whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Bank has complied with applicable written law, or other general or special directions issued by the governing body of the Bank;
- Whether the Bank has performed according to its powers, functions and duties; and
- Whether the resources of the Bank 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

1.5.1.1. Susp. A/C Amount paid to pending deliveries (GL code – 393470)

Audit Issue	Management Comment	Recommendation
<p>Advances made to suppliers to obtain IT equipment are included in the above account and once the payment is completed, it will be capitalized depending on the nature of the service obtained. A balance of Rs.1,185,766,976 was shown in the aforesaid account as at 31 December 2022 and following observations are made in this regard.</p> <p>(i) Certain balances amounting to Rs.813,556,548 had been outstanding for more than one year period without taking actions to clear the outstanding balances.</p> <p>(ii) As aforesaid, advance payments made to suppliers are recorded in the above account. The outstanding balance of the above account includes an advance payment of Rs.184,220,563 made to two suppliers (Just In Time and Innova IT systems) for the purchase of IT equipment under Data warehouse Project and Application Rewrite Program. However, a provision had been made for the full amount due to non-existence of assets.</p>	<p>Suspense A/C Amount paid to pending deliveries (GL code – 393470) consists the advance payments made to suppliers. The amounts can be capitalized only when the balance payments made upon completion of the projects. Until such time the amounts have been stationed in this account. Suspense A/C Amount paid to pending deliverables will be cleared at the completion of the project.</p> <p>Present position is as follows. Application Re-write Project – Rs.49.8 million. - Payment finalization is in progress with User Departments target completion 31 October 2023. Working in progress with Finance department to write off the balance.</p> <p>DWH project- Based on the decision made by the management, the DWH project was terminated. Accordingly, a provision of Rs.137,187,229.88 has been made.</p>	<p>It is recommended to take necessary actions to clear the long outstanding balances and to ensure the accurate recognition, classification and presentation of balances when preparing financial statements.</p> <p>Further, since most of these items are related to the procurement of software, these may not be useful with the significant time delay taken for the completion of the project.</p>

(iii) As per the schedule given by the supplies division, a balance of Rs. 84,631,716 had been remained as long outstanding and the details had not been submitted to audit in this regard. However, as per the available evidences, it reveals that, the Bank has made a payment of Rs.84,631,716 to JIT Technologies in 2018 which is not supported by any documentary evidences. It was further revealed that, this is an additional payment which is not covered under the agreement entered towards the digital banking project of the Bank.

Letters have been sent to JIT Technologies requesting the documentary evidences on 18 April 2023 and 17 August 2023. However, no response received to date from JIT.

1.5.2. Advances

Audit Issue

1.5.2.1 The number of 114,310 loans amounting to Rs.484,180.94 million had been granted by the Bank during the year 2022 and out of that 2380 number of loans amounting to Rs.5,953.74 million had been transferred to non-performing category as at 31 December 2022. Further, out of the above loans transferred to NPL category, the Bank was unable to recover even a single installment from 450 number of loans amounting to Rs.1,997.51 million during the year under review.

1.5.2.2 Loans aggregating to Rs.642.12 million had been written off by the Bank during the year 2022 which comprise from capital of Rs.276.67 million and

Management Comment

Total loans granted during the year 2022 was Rs.484,180.94 million and at the year 2022 remaining Capital of the said advances was Rs.466,267 million. Accordingly, the percentage of transferring to NP category is 1.2%(i.e., Rs 5,953.74 million out of Rs 484,180.94 million loans granted), which is acceptable given the macro-economic conditions in the country. Out of the 2380 number of non-performing loans amounting to Rs.5,953.74 million, bank was unable to recover even a single installment from 450 accounts capital amounting to Rs, 1,997.51 million and Interest in suspense Rs. 216.44 million as at 31.12.2022. In addition, the total value of in the Interest Suspense as at 31.12.2022 was approximately Rs 66,667.60 million out of which 65% comprised with the accumulated interest for the top 25 NPLs amounting to Rs.43,447.37 million. The Bank adopted the write off policy

Recommendation

Take necessary actions to grant loans and advances to eligible customers in accordance with approved guidelines and circulars and to recover effectively and efficiently. Further, take necessary actions against responsible parties for non compliances and strengthen the internal controls of the bank.

interest of Rs.365.45 million. Rs.15.35 million had been recovered during the year 2022 from the written off balances. Details of written off balances and written off recoveries during last five years are given below.

Year	Rs. million			
	Capital	Interest	Total	Written-off Recoveries
2018	254.86	641.05	895.91	25.96
2019	329.29	74.00	403.29	71.53
2020	363.20	1,321.12	1,684.32	13.57
2021	108.86	761.26	870.12	15.29
2022	276.67	365.45	642.12	15.35

for unrecoverable NP debts in every year as applicable, for the purpose of proper reflection of books of accounts. All possible recovery measures have been continued to recover such write-off advances.

Further, the recovery of write-off debts has been set as a key performance indicator of the Recoveries Department and is closely monitored on monthly basis, to ensure the effectiveness of recovery process. As at 31 December 2022 Capital Written off value was Rs. 276.67 million. Further, amount recovered YTD Rs.15.35 million and Percentage of Amount Recovered against Amount written off is 5.5 percent. In addition, emphasis that the bank does not written-off the interest and out of capital written-off during 2022 included 01 borrower written-off value amounting to Rs.229.89 million consisted of 03 facilities.

1.5.2.3 Loans categorized under Stage 3 had been increased up to Rs.332,794 million by Rs.179,443 million as at 31 December 2022 when compared with the preceding year. Further, loans categorized under stage 2 had been increased up to Rs.276,877 million from Rs.207,799 million of the preceding year.

Sri Lankan Airlines (Rs. 57.5 billion), Ceylon Fertilizer Company (Rs. 24.1 billion), and Colombo Commercial Fertilizer (Rs. 15.1 billion) mainly were moved to stage 3 during Q2 2022 which was assessed under individual impairment since then due to the presence of objective evidence. The increase in stage 2 is mainly due to moving DST from stage 1 to stage 2 as at 31 December 2022 post sovereign downgrade.

1.5.2.4 Total Non -performing over draft (OD) balance over Rs.5 million of the Bank as at 31 December 2022 was Rs.7,552.87 million including the capital of Rs.2,168.83 million and interest of Rs. 5,384.04 million.

Total Non-performing overdraft (OD) balance over Rs.5 million of the Bank as at 31 August 2023 increased by Rs.684.60 million in capital and by 18 number of accounts. This adverse effect we already identified and closely monitored daily basis and review every month-end.

1.5.2.5 Total outstanding balance of top 10 non-performing loans (NPLs) as at 31 December 2022 was Rs.71,439.41

The capital position of NP debts has been decreased due to all possible

million including the capital of Rs.40,520.61 million and interest of Rs.30,918.80 million. Details are given below.

measures that were taken to recover of the debts.

Capital outstanding as at 31.12.2022 - Rs.40,520.61 million

Capital outstanding as at 31.08.2023 - Rs. 37,413.03 million.

Accordingly 8% (Rs. 3,107.58 million) reduction has been achieved.

	Name of the customer	Capital Outstanding Balance Rs.million	Interest Outstanding Balance Rs.million	Total Outstanding Balance Rs.million
1	Laugfs Gas PLC	835.76	142.84	978.59
	Laugfs Engineering (pvt) Ltd	123.31	15.55	138.86
	Laugfs Terminals Ltd	8,461.04	1,154.56	9,615.60
		9,420.11	1,312.94	10,733.05
2	Srei equipment finance Limited	5,493.75	499.81	5,993.56
3	W.M.Mendis& company Limited	3,869.20	507.67	4,376.87
4	The Grand Mountain Hotel(pvt)Ltd	1,467.23	272.12	1,739.35
	Lak steel Engineering private Ltd	1,813.88	283.32	2,097.20
	Lak Gypsum private Limited	168.79	23.49	192.28
	Lak Brand Furniture	59.12	8.40	67.52
		3,509.02	587.33	4,096.35
5	Huravee International (pvt) Ltd	3,479.38	1,497.87	4,977.24
6	Mihin Lanka private Ltd	3,391.48	439.07	3,830.54
7	CML MDT Construction Ltd	2,672.64	1,865.75	4,538.39
	Walkers Piling (pvt) Ltd	343.45	259.83	603.28
	Walkers Equipment (pvt) Ltd	293.16	208.78	501.94
	Walkers sons and co-Engineers(pvt) Ltd	25.55	49.51	75.06
	MTD Walkers PLC	2.13	2.47	4.60
		3,336.93	2,386.35	5,723.27
8	Yashoda Holdings (pvt) Ltd	2,424.32	18,021.82	20,446.14
	Yashoda Marketing services (pvt) Ltd	0.73	5.32	6.06
	Yashoda Advertising (pvt) Ltd	0.47	3.44	3.91
	Yuni Agencies Transport (pvt) Ltd	0.84	6.18	7.02
	RuhunuAgro Fertilizer Co.Ltd	498.50	3,769.72	4,268.22
	Ruhunu Plywood	90.25	586.73	676.98
	Yuni printers (pvt) Ltd	11.02	91.77	102.79
	Murni Bakery Equipment	4.30	27.04	31.34
		3,030.44	22,512.02	25,542.46
9	Nawaloka Steel Industries (pvt) Ltd	524.75	162.62	687.38
	Nawaloka Construction company (pvt) Ltd	2,226.12	539.91	2,766.04
	East West Marketing (pvt) Ltd	138.50	22.96	161.46
	New Ashford International	33.18	6.92	40.11

		2,922.56	732.42	3,654.98
10	The Co-operative whole Sale Establishment	2,067.74	443.35	2,511.09
		40,520.60	30,918.80	71,439.41

1.5.2.6 Total exposure to State Owned Enterprises (SOEs)

- (i) Total outstanding loans and advances belonging to SOEs have been recorded as Rs.871,619 million or 45.5 percent from total loans and advances portfolio of the Bank as at 31 December 2022. However, outstanding loan balances from SOE's had been reduced by Rs.65,767 million or 7 percent as compared with the preceding year. Noted the comments.
- (ii) The aggregated amount of investments and other receivables from government was Rs.1,024,096 million as at 31 December 2022 and accordingly, total exposure to SOE's was Rs.1,895,715 million or 63.79 percent from total assets of the Bank. Noted the comments.
- (iii) Total outstanding balance of loans and advances belonging to State Owned Enterprises (SOEs) and investments and other receivables from government during the last 5 years period are given below. Noted the comments.

Loans & Advances	2018	2019	2020	2021	2022
Loans & Advances belongs to SOEs (Rs.million)	551,110	601,297	844,821	937,386	871,619
Increase of SOEs Balance compared to previous year (Rs.million)	197,821	50,197	243,525	92,564	(65,767)
Increase of SOEs balance compared to previous year %	56.00	9.11	40.55	10.96	(7.02)
Total Loans and Advances (Rs.million)	1,334,420	1,386,481	1,723,466	1,936,974	1,915,788
% of SOEs Balance out of Bank's total Loans & Advances	41.30	43.37	49.02	48.39	45.50
Total Bank's Assets (Rs.million)	1,734,703	1,873,406	2,230,119	2,647,641	2,972,028
% of Loan & Advance SOEs Balance out of Total Assets	31.77	32.10	37.88	35.40	29.33
Investment & Other Receivable from Government (Rs.million)	328,158	419,217	435,343	672,155	1,024,096
Total Asset exposure of SOEs	879,257	1,020,514	1,280,164	1,609,540	1,895,715
% of SOE exposure out of Total Assets	50.69	54.47	57.40	60.79	63.79
Total Payable to SOEs (Borrowings & Deposits)	271,085	217,791	222,257	226,722	418,932

(iv) Aggregated outstanding balances of Deputy Secretary to Treasury, Road Development Authority, National Water Supply and Drainage Board and interest receivable on senior citizen deposits, enterprise Sri Lanka and incentive on inward work remittances from government treasury amounting to Rs. 323,401.67 million had been set off by issuing treasury bonds during the year 2022 instead of paying cash. Details are given below.

DST –Treasury Bonds were issued to the bank to reduce the OD balance of DST. The bank initially insisted on repayment of loan on cash basis. However, we were instructed to accept government securities instead. These were not investment decisions of the bank since bank was instructed to accept these T bonds in place of the aforesaid settlements. Despite the slightly more attractive rates for long-term bonds, the bank opted for short-term securities (Treasury bills) due to the severe liquidity crisis it was facing at the time. Since this option was not available, bank requested for Treasury Bonds with the shortest maturities. Most of these were issued at the WAYR of the previous Treasury bond auction at the time and these yields were lower than the

	Rs.million	
Deputy Secretary to Treasury	309,999.96	market rates. Hence, to avoid possible MTM losses to the bank, these were booked under Amortised Cost (HTM) with the approval from ALCO.
Road Development Authority	3,364.76	RDA –interest paid by issuing Treasury Bonds in 2022, however in June 2023 all the dues were settled upon receipt of funds from General Treasury.
National water supply and Drainage Board	6,672.19	NWSDB – Treasury Bonds issued in August 2022 and February 2023 to recover part of the due installments. Customer remitted funds on 26 September 2023 to recover all due installments up to 30.06.2023.
Senior citizen	2,195.98	Senior Citizen-Please note that the full senior citizen interest subsidy claim for Q2, 2021 was Rs. 3,233,999,309.81
Enterprise Sri Lanka	233.41	
Incentive on Inward Workers Remittances	935.37	
Total	323,401.67	

1.5.2.7 Top 10 SOE loans & advances

Top 10 SOE loans as at 31 December 2022 had been recorded as Rs. 811,307 million with capital of Rs. 715,005 million and interest of Rs. 27,308 million which presents 82 percent of total outstanding balance of loans & advances belonging to SOEs. A loan balance of USD 1,093 million to Ceylon Petroleum Corporation (CPC) had been taken over by the government treasury as at 31 December 2022. However, above taken over loans had not been adjusted in the books of the Bank and interest is accrued in the system. Therefore, the Bank needs to finalize the arrangement with general treasury and CPC. Details of top ten SOE loans as at 31 December 2022 are given below.

Noted the comments.

The present position of the CPC loan taking over by Government Treasury is as follows;

Though General Treasury so far intervened on all the negotiations of transferring the liability towards Government books, the process has been now undertaken by the IMF Debt Restructuring Committee. The discussions are still going-on with them by both Banks to finalize the terms and conditions of the process.

We have requested from DST by our letter dated 04 September 2023, to settle interest of existing liabilities by allocating the funds which already available with Ministry of Finance to service the interest.

Institute	Outstanding as at 31 December 2022 Rs. million	Security	Security Value
Deputy Secretary to Treasury	60,323	Clean	-
Ceylon Petroleum Corporation	414,553	Treasury Indemnity Treasury Guarantee	USD 1650 Mn USD 7.73 Mn
Ceylon Electricity Board	107,642	Treasury Guarantee Mortgage Receivable Clean (Rs. 22,411 Mn)	Rs. 6,500 Mn Rs. 38,800 Mn -
Road Development Authority	71,697	Treasury Guarantee Treasury Indemnity Letter of Undertaking from General Treasury Assignment of cash deposit	Rs. 35,000 Mn USD 44.72 Mn Rs. 8,380.09 Mn Rs. 12,892.88 Mn Rs. 3,688 Mn
Sri Lankan Air Lines	57,536	Treasury Guarantee Letter of Comfort from General Treasury	Rs. 8,289.39 Mn USD 5.38 Mn Rs. 13,350 Mn USD 100 Mn
Ceylon Fertilizer Company Limited	25,666	Letter of Comfort from General Treasury Fixed Deposits	Rs. 28,827.98 Mn Rs. 1,270.42 Mn
Director Pensions	21,651	Treasury Guarantee	MOU & Primary Documents
Colombo Commercial Fertilizer Ltd	16,054	Letter of Comfort from General Treasury	Rs. 18,637.65 Mn
National Water Supplies & Drainage Board	15,793	Treasury Guarantee Letter of Undertaking from General Treasury	Rs. 3,961.03 Mn Euro 7,624.77 Mn Rs. 11,680.86 Mn
Ceylon Shipping Corporation	20,392	Treasury Guarantee	USD 71.91 Mn
Total	811,307		

1.5.2.8 Bimpuh Finance PLC

Bimpuh Finance is a micro finance company belongs to the Daya Group established in 2007 and engaged in micro financial services since 2012. Three term loans aggregating to Rs.700 million had been granted to the aforesaid company during the period from 2017-2019. Following observations were made in this regard.

- (i) According to the special conditions No.1 of the offer letters dated 10 March 2017, 17 December 2018 and 25 April 2019, it is required to provide the list of loans receivables to the Bank on first week of each following quarter. However, actions had not been taken by the Bank to get such updated loan list according to the special condition of offer letters.

The main reason for company to non-performing was the COVID-19 impact. Until March 2020, the company serviced all their installments without any overdue. However, after the COVID-19 impact, as a non-banking financial institution the company had to accommodate the moratoriums to its customer as stipulated by the CBSL and this had a significant impact on their collection.

Quarterly reminders were sent to customer via emails and obtained list of loan receivables for 31 March 2021. It is at this point that bank receives the up to date loan list after replacement of arrears loans and settled loans until the facilities were transferred to NP.

However during the recovery process the Bank was able to obtain the corporate guarantee of Daya Group.

- (ii) As per the special conditions No.2 and 3 of the aforesaid offer letters, borrower should replace any loan receivable contract which gets in to arrears for more than three months with a performing contract and to replace any contracts which are settled. However, such follow up had not been done by the Bank.

In addition to the book debts, Bank has obtained Corporate Guarantee of Daya Group as collateral and approval was obtained by Board Executive Credit Committee.

- (iii) As per Section 6.2.8 of Chapter 5 of the Credit Manual of the Bank, maximum

The said loans were granted against micro finance loans receivables of the Co, which the maturity period goes more than

repayment period for the loans granted against book debts is one year. However contrary to the said conditions, the repayment period of 3 to 5 years had been granted.

1 year and the same has been approved by BECC.

(iv) As per the recommendations made by the risk management division for the Board Executive Credit Committee (BECC) paper No.1133/2020 (at the time of rescheduling), it was mentioned that the security of these loans are weak and the risk of the security is high. However, disregarding above, the loans had been approved on the grounds of adverse situations and subsequently all three loans were become non performing. Those had been rescheduled and a capital moratorium had also been granted with the same security.

Second rescheduling was done on 31.05.2022 as per the request of borrowing company with the intention of rehabilitating the borrower and to uplift the current financial situation of the borrowing company. Rescheduling arrangement for these three facilities was done based on the existing securities aligning the Circular Guidelines of G. I. Circular No. 734/2005 (17). At that rescheduling stage, the bank mainly focused the repayments of the customer with considering the vulnerabilities that the company has faced with COVID 19 impact. During the continuous discussions, it was not revealed any immovable asset/ any other asset to securitize for the loan facilities which were going to be rescheduled. The bank had not any other alternative than depending on the existing securities.

(v) This customer's Credit Risk Rating figures deteriorated from 'BB' to 'C' since the period begins from 2019 to 2022 according to the risk rating figures mentioned in the loan file.

As per the Credit Risk Rating done by the Credit Unit, the Credit Risk Rating of the Company has downgraded from "BB" to "C", which has been communicated to the approving authorities.

(vi) These loans were transferred to non performing category on 06 September 2022 due to non-payment of interest as agreed. According to the loan category, these loans can be granted for a one year period as per Credit Recovery Manual. However, the Bank had extended the tenor of loans up to 9 to 11 years from the initial granted date without having satisfactory recoveries. Not obtaining strong securities, unavailability of proper repayment plan and weak credit evaluation were observed as the main weaknesses

This rescheduling arrangement was done subject to of internal approval with intention of rehabilitating the borrower's financial condition. Borrowing company had requested to reduce monthly installment of facilities. Therefore, tenor was extended up to 6 years again to submit concessional monthly installment. It was aligned with the guidelines of G I Circular No. 734/2005 (17). The bank received Rs. 51.93Mn payments for both capital and interest after the rescheduling arrangement. The main purpose of the rescheduling was to get the payments from the borrowing company even though the loan facilities are in NP category.

towards these loans. Total outstanding balance of Rs. 422.61 million had been recorded as at 06 September 2022 including capital balance of Rs.417.92 million.

Necessary actions will be taken to normalize all these CIFs before 31.12.2023.

(vii) Though there were no any loan balances available, 05 Customer Identification Numbers (CIF) were observed in the system for the same customer as follows.

450012095,1740003288,
2240046224,680023200

(viii) License of above company had been cancelled with effect from 01 September 2023 and accordingly, recoverability of above loans are doubtful.

The recoverability of the loan facilities is totally depending on the Corporate Guarantee of Daya Group (Pvt) Ltd. A legal case was filed against the borrower and the corporate guarantor. As it is not pragmatic to initiate legal action against the Mortgage Bond over the book debts of an insolvent company, the bank has not filed any Mortgage Bond action. Throughout the said rescheduling, the bank could recover a considerable amount to both capital and interest. The balance will be recovered through both Money Recovery action and negotiation with the customer.

1.5.2.9 Loans granted to Olympus Constructions

Olympus constructions is a subsidiary of Daya Group company which was formulated in 2007 in the name of Daya Constructions and re-incorporated as Olympus Constructions in 2014 which was engaged in the business of constructions field. As per the details in the loan portfolio as at 31 December 2021,07 loans aggregating to Rs.581.63 million (Capital Rs.518.12 million, accrued interest of Rs.57.42 million, penalty interest and late charges of Rs.6.019 million) were recorded as the receivable from the customer. Following observation is made.

The proposal to waive-off the said accrued interest of Olympus Construction was approved by the Board of Directors of the bank vide BP 962/2021.

Basically, General Instruction Circular No 734/2005(17) issued to reschedule the NP advances, has also proposed to differ 30% of the accrued interest component on the exceptional circumstances.

The facilities were considered when the Company was categorized as non-performing customer considering following factors,

(i) These loans had been granted with the approval of the Executive Credit

➤ To strengthen the securities of the

Committee on exceptional conditions and the several waive offs also approved by the Executive Credit Committee after many reschedulements. As per the details forwarded to the audit, the total waive-off of Rs.33.13 million had been granted to the client.

1.5.2.10 Loans granted for W.M.Mendis & Company

Total loan capital amounting to Rs.3,063 million had been granted by the Bank to the above customer as at 31 December 2020.

(i) As per the Title 5, Para 12 of the Credit Procedure Manual of the Bank, Bank's obligation records should be checked to ensure the unavailability of NPL loans before granting any loan. However, contrary to the above, 3 loans aggregating to Rs.378 million had been granted by the Bank to the above customer.

(ii) As per the Board Executive Credit Committee (BECC) paper No.708/2021 dated 28 June 2021, capital outstanding of Rs.3,062.7 million had been rescheduled in to 4 loans at 9.75 percent interest up to 7 years (with 18 months grace period for capital repayment) and arrears interest and penal interest amounting to Rs.806.9 million rescheduled in to 4 loans at 9.75 percent interest up to 3 years.

(a) As per the para 9 of BECC paper No.708/2021 dated 28 June 2021,

Company by executing secondary mortgage of ENA plant which was already commenced the construction with the SCB funds and considering its market value, probable value enhancement along with the time.

➤ To revolve the existing short term facilities according to the credit procedure manual section 02 (delegated credit authority) schedule 04 – Empowerment to CBD/OBU officers with regard to Trade Finance transactions to consider on 120% recovery basis to improve future recovery of the facilities.

➤ With intension to reduce Non-performing portfolio by revolving the short term facilities on higher percentages of recovery.

To support the Company to continue the operations which is required for the Bank to go for a workable recovery plan.

The rescheduling has been performed to strengthen the loan agreement from the perspective of recovery initiatives.

As per BECC/708/2021 interest concession of Rs.400 million was granted out of the Rs.1,051 million accrued at 24 percent per annum for the OD facilities. This was incorporated in the offer letter dated 19 July 2021, this concession was allowed only if the repayments are made satisfactorily.

Personal guarantee and the promissory notes have been taken for all eight (08) reschedule loans in addition to the primary mortgage at Morogolla and secondary mortgage over the Kalkuda plant which is now in operation.

The total capital outstanding balance has been increased inclusive of the capitalized accrued interest loans proposed under rescheduling programme. The asset base of the guarantors was not clearly stated in the asset declaration forms of the personal guarantors. However, the asset base of the

loans had been rescheduled by removing Rs.400 million interest on overdraft facilities as “Differ and later waive off”. company is significantly increasing due to starting of the operation of the Kalkuda ethanol manufacturing plant.

- (b) Obtaining of personal guarantees of 2 board directors had been recommended as per the Section 11.4 of above BECC paper. Accordingly, personal guarantees of directors and promissory notes had been obtained for only 7 loans amounting to Rs.1,632.2 million. However, guaranteed directors had submitted value of shares of Rs.100 million each only through the form No.149 and even proof evidences had not been obtained by the Bank.
- (c) The total outstanding balance of Rs.4,376.86 million was recorded under above customer as at 31 December 2022 which includes capital outstanding of Rs.3,869.2 million and interest outstanding of Rs.507.6 million. However, it was observed that the value of the available securities was Rs.1,912.8 million (as at 04 October 2022) which is only enough to recover 43.7 percent of the loan value.

1.5.2.11 Loans granted to PC House PLC
Import facility of Rs.200 million with Trust Receipt (TR) sub limit of Rs.180 million had been granted to aforesaid customer and due to the risk involved with the company subsequently it had been reduced up to Rs. 121 million. However, the approved facility had been expired on 30 August 2009 and outstanding balances were transferred to non - performing category. Accordingly, the Bank has rescheduled the non performing TR loans and approval was granted via Board Executive Credit Committee (BECC)

Judgment was given in favor of the Bank; company has appealed to the Supreme Court against the judgment and appeal has not yet been listed.

Bank has *parate* executed the two mortgaged properties on 26 January 2018 and since there were no successful bidders. Properties were vested to the bank. Within the same year those properties were sold to Rs. 47.75 million

paper No. 678/2009 on 24 December 2009. At the time of reschedulement, the Bank has granted a block loan amounting to Rs.15 million over the mortgage of two immovable properties with forced sale value (FSV) of Rs. 15.5 million. The existing TR facility limit renewed and reduced to Rs. 106 million (with sub limit of LC amounting to Rs. 30 million) for another one year period. TR facility of Rs. 106 million was secured against joint & several guarantees of Directors and mortgaged over stocks at Mattakkuliya, Unity Plaza & Majestic City with forced sales value (FSV) of Rs.210 million. As per the BECC paper No. 678/2009, the reschedulement proposal has been recommended since there is no option other than filing legal action against the company. Following observations were made in this regard,

- (i) A case bearing HC/CIVIL/321/2013/MR had been filed by the Bank against the joint & several guarantees of the Directors and loan documents. Though the judgement was given in favor of the Bank, company has appealed in the Supreme Court against the judgment.
- (ii) As per the valuation report of the panel valuers' dated 17 September 2012, forced sale value of the stocks at Mattakkuliya and Unity Plaza was Rs.149 million. Though the TR facilities were secured against mortgaged over those stocks, Bank was failed to realize any stock against the recoveries of non-performing loan outstanding. Hence, TR facilities were remained outstanding as at 30 September 2022 and total outstanding amount of Rs.196.3 million may be loss to the Bank since no more realizable securities are available.

by way of tendering the properties and recovered a part of the debt.

Outstanding as per 31 August 2023– Capital Rs.63.88 million /normal interest -Rs. 110.71million. /Penal Rs. 32.01 million.

Noted the comments.

Disciplinary actions were taken against the relevant staff members.

The officers were advised to adhere to the stipulated guideline in future.

(iii) The TR loans had been granted on the Joint & several guarantees of Directors. As per the Section 5.9.4 of the Credit Procedure Manual, it is necessary to obtain a list of assets owned by each guarantor to ensure whether they are capable to repay the loan and obtain their written agreement not to dispose of declared assets without prior consent of the Bank. However, no such documents were available for the audit

1.6. Non -compliance with Tax Regulations

Audit Issue	Management Comment	Recommendation
<p>1.6.1. Though Debit Tax had been abolished as at 31 December 2022, tax payable balance of Rs.8,537,114 was existed in the detailed balance sheet of the Bank as at 31 December 2022.</p>	<p>Sent a letter to Commissioner General on March 15, 2023, requesting advice on the Debit Tax collection after abolishment in 2019.</p>	<p>Take necessary actions to adhere with issued circulars and guidelines.</p>
<p>1.6.2. Underpayment of Advance Personal Income Tax (APIT) Advance Personal Income Tax had been paid by the Bank on monthly basis. The already paid APIT amount is deducted from a particular month APIT computation to derive the payable amount. The Bank has considered the APIT paid amount from April to August 2022 as Rs. 17,853,140 when computing the APIT for the month of September 2022. However, as per the August month computation, the accumulated APIT payable balance as at end of August 2022 was Rs.11,902,093. Due to this, the advance personal income tax expense and payable balance had been understated by Rs. 6,433,878 (including tax on tax).</p>	<p>Noted, the shortfall will be paid shortly post due approval process. To save any doubt, this is a one-off error which has not been repeated.</p>	
<p>1.6.3. Extraordinary Gazette No: 1868/10 which published on 23 June 2014 – Value Added Tax on Financial Services.</p>		

According to the Schedule 02 (c) of the Extraordinary Gazette No: 1868/10 published on 23 June 2014 by the Commissioner General of Inland Revenue relevant to the Value Added Tax on Financial Services, Emolument payable include both aggregate benefits in money and not in money payable to the employee. Therefore, entity shall consider the benefits provided to the employee in the form of non-cash as well. However, Bank had not considered the non-cash benefits as emolument in computing VAT on Financial Service. Hence an understatement of the expenses and the liability by Rs. 39,603,848 was observed.

The reasons for the highlighted differences are as follows;

1. Annual Subscription payment to professional Bodies include amongst the others, the bank's license payment to CBSL and the bank payment to CEFT as bank's subscriptions which are Rs. 38 million and Rs. 6.5 million, balance part will be considered as emolument at FS VAT settlement process with IRD.
2. Messengers Uniform account debited for the uniforms like bank security officers, these uniforms could not be the staff personal benefit and they must wear it only in the bank premises.
3. Subsistence & lodging and Staff Travelling are the reimbursement of expenses for the bank's official purpose. Eg. Reimbursement of expenditure for Branch visits by Internal Auditors.
4. Some branches used outsource personnel for non-performing loan recovery purposes and the payment made to them through Incentive pays on recovery of non-performing loan.
5. C/A medical claims paid-"c" category used for the medical payment to pensioners.

- 1.6.4. The Letter no: CGIR had declared the concessionary loan rate only for the YA 2018/2019 as 9.08%. The rate could not be identified for the purpose of calculating the Noncash benefit of concessionary Loan rate shall be considered on employee earning based on 50 % of difference between concessionary loan rate and the market loan rate for the YA 2022/2023.
- MF/FP/13/CM/2018/82 dated 20 June 2018, issued by the Deputy Secretary to the Treasury – Non Cash Benefit on Advance Personal Income Tax
- As per the Section 4 (2) of the letter no: MF/FP/13/CM/2018/82 dated 20 June 2018, issued by the Deputy Secretary to the Treasury, non-cash benefit obtained through concessionary loan rates shall be considered as employee earning by calculating 50 percent of difference

between concessionary loan rate and the market loan rate. Thus the entity had not considered the non-cash benefit on concessionary loan interest when assessing the advance personal income tax of its employees for the year 2022.

1.6.5. Inland Revenue Circular No: SEC/2020/02 dated 18 December 2020

According to the Section 2 of the Inland Revenue Circular No: SEC/2020/02 dated 18 December 2020, an employer shall retain 12 percent from commuted pension and gratuity payments when the payment exceeds Rs.5,000,000. However, the Bank had not complied accordingly and had released the full commuted pension and gratuity without retaining 12 percent from the amount which exceeds Rs.5,000,000. As a result, the Bank had not retained the amount of Rs.1,050,445 relevant to the observed sample of 08 retired persons. Therefore, the Bank had released the retainable amount contrary to the direction of the PAYE Audit Branch of Department of Inland Revenue. Due to that weakness advanced personal income tax charging procedure had been violated and that had caused to evade the tax deduction made from the commuted pension and gratuity.

According to section 2 of the Inland Revenue Circular No: SEC/2020/02, the correct practice started from January 1, 2023

1.6.6. Section 11(Main Deduction) of the Inland Revenue Act No. 24 of 2017

As per the Section 11 (Main deduction) of the Inland Revenue Act No. 24 of 2017, the expenses shall be deducted to the extent that they are incurred during the year by the person, in the production of income from the business or investment. Therefore, the expenses that incurred to generate the exempted income, shall be excluded from expenses and added back to the

Considering the Bank's prior practice, and the recently successfully concluded IRD prior year tax settlements, the Department has already accepted to add back only the following based on the LIBOR rate:

- The relevant interest cost pertaining to Sovereign bond income
- Interest income on SLDBs and
- Interest on foreign loan on the LIBOR rate.

profit in computing income tax according to income tax law. However, the Bank had not excluded the administration expenses, overhead expenses, employee cost proportionately which contributed to earn exempted income of foreign currency earning (Sovereign bond income, interest on SLDB and interest on foreign loan). Due to that weakness, income tax payable and expense had been understated.

1.6.7. Stamp duty (Special provisions) Act No. 12 of 2006

As per the Inland Revenue, Stamp Duty (Special Provisions) Act No. 12 of 2006, the amount of stamp duty in respect of such promissory notes, remit quarterly, to the Commissioner General within 15 days from the end of the relevant quarter ending on 31st March, 30th June, 30th September and 31st December of every year. However, some branches had not complied with the aforesaid provision of this Act.

Noted the comments.

Stamp duty is remitted to Inland Revenue without delays at present.

The relevant officers were advised to adhere to the stipulated guidelines

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit before tax of Rs.21,338.4 million and the corresponding profit in the preceding year amounted to Rs.30,386.6 million. Therefore, a deterioration amounting to Rs.9,048.2 million of the financial result was observed. The reasons for the deterioration are increase in the interest expenses and increase in impairment charges.

2.2 Trend Analysis of major Income and Expenditure items

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

Description	Variance Amount Increase/(Decrease) (Rs'000)	Variance %	Reason for the Variance
Interest Income	124,605,972	63.15	Increase in interest rates
Interest Expense	131,308,747	114.31	Increase in interest rates
Impairment Charge	18,873,631	130.41	Increase in loans categorized under stage 3 & impact on economic factors

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 with the comparison to the Sector Ratios published by the Central Bank of Sri Lanka.

Description	Sector Ratio	Bank	
		2022	2021
Performance Ratios			
Return on Equity (ROE)	10.5	12.2	19.9
Return on Assets (ROA)	1.0	0.8	1.2
Interest Margin	4.0	2.7	3.4
Assets Quality Ratio			
Impaired Loans (Stage 3) Ratio	11.3	12.8	4
Capital Adequacy Ratios			
Tier 1 Capital(Minimum 8.5%)	12.3	11.9	12.6
Total Capital(Minimum 14%)	18.3	16.3	17.8
Statutory Ratio			
Liquid Assets Ratio (Minimum Requirement 20%)	29.9	21.37	23.52
Liquidity Coverage Ratio (Minimum Requirement 100%)		Rupee – 213 All currency – 119.47	Rupee - 155.83 All currency - 105.71

3. Operational Review

3.1 Uneconomic Transactions

Audit Issue

Data Warehouse & Business Intelligence System Project
An amount Rs. 402,026,172 (Before tax) had been incurred by the Bank as at 30 May 2022 for the above project and the project had not been completed. Out of the 11 modules proposed, only 4 modules [DW & DQ I Module, DW & DQ II Module (only 5 Reports), Operational Risk Module, Market Risk module] were Go live and expected results of those modules were not delivered to the users. Further, it was observed that the software license was expired in the year 2020 and at present completed modules were also not functioning.

Management Comment

Based on the decision made by the management, the DWH project was terminated. Accordingly, a provision of Rs. 137,187,229.88 has been made.

Recommendation

Take necessary actions to ensure the effective and efficient use of bank funds and strengthen the internal controls. Further, proper investigation should be carried out regarding the DWH & BI system which was suspended after incurring significant cost without any benefit to the Bank and should take necessary legal actions to recover the cost or complete the project.

3.2 Identified Losses

Audit Issue	Management Comment	Recommendation
An amount of Rs.159.1 million had been recorded as total loss to the Bank for the year 2022. Significant amount from the above balance comprised from execution, delivery, and process management amounting to Rs.83.31 million and mainly included correction of backlog balances amounting to Rs.38.1 million in General Ledgers of four branches and Rs.36.8 million of long outstanding amounts from previous years transferred to operational losses during the year 2022. Further, the total losses include internal frauds amount of Rs.41.59 million occurred in 4 branches.	Noted the comments. Bank has implemented smooth internal control system at present. The relevant officers were advised to adhere to the stipulated guideline in future.	Take necessary actions to strengthen the internal controls and recover losses from relevant parties.

3.3 Transactions of Contentious Nature

Audit Issue	Management Comment	Recommendation
3.3.1.As per the Section 9 (b) of the Chapter 06 of the Procurement Manual of the Bank, disposal of the motor vehicle needs to be proceed after identification through the Board of Survey and by obtaining Executive Operations Committee approval. However, following vehicles had been sold out to the corporate members by violating the aforesaid conditions and without obtaining valuation reports.	As per the BHRRC decision No.05/2018 having considered their long and dedicated service with the Bank and that these vehicles had already been purchased by the Bank about one year ago, the three Senior Executives should be given the opportunity to obtain loans under the loan scheme approved vide BHRRC No.51/2018, although any of them does not have two years ahead to serve in the Bank.	Take necessary actions to adhere with the established circulars and guidelines without any deviation.

Vehicle No.	Date of Purchase	Date of Disposal
WPCAY - 6974	22.03.2018	31.10.2018
WPCAY - 6992	22.03.2018	14.03.2019
WPCAY - 6994	23.03.2018	21.03.2019

3.3.2.As per the Section 2 of Direction

No.01 of 2018 of the Central Bank of Sri Lanka (CBSL) dated 08 February 2018, the maximum amount of loan should be limited to the specified percentage of the market value of the property mortgaged. However, contrary to the above direction, 100 percent from the invoice value of the vehicle has been granted as vehicle loans for corporate members under the approval granted through BHRRC paper No.51/2018.

According to the special vehicle loan introduced under BHRRC 51/2018, Loan can be granted only for the new vehicles. Therefore, the Invoice value treated as loan amount, as the facilities could be considered up to 100% of the purchase value subjected to the limits applicable to the respective position.

3.3.3. At the COPE meeting held on 2019, it was emphasized the need to have a clear policy for providing transport to the members of the Corporate Management and accordingly, via the decision to the Board Paper No.723/2019 dated 30 September 2019, the board has decided to provide a Bank maintained vehicle for official use and to discontinue the policy approved under BHRRC paper No.51/2018 forthwith. Further, those who have obtained loans under the policy approved via BHRRC paper No.51/2018, vehicles will not be provided since they are already having purchased vehicles. Following observations were made on the 16 loans granted under the aforesaid loan scheme.

I. As per the conditions stipulated in the offer letter and the consent letter, any sum due from the loan at the time of retirement need to be recovered from the terminal benefits of such employees. However, it was observed that, following retired employees on 31 December 2022 had not settled the vehicle loans granted under above scheme up to June 2023. Details are given below.

II.

The mentioned loan facilities are granted as per the BHRRC 51/2018. Even though the scheme was cancelled vide BP 723/2019, the terms and conditions under 51/2018 were still applicable for those executives who had already obtained the loan facilities under the said scheme. Subsequently, the discounting facility at the time of

Since the BHRRC paper No.51/2018 discontinued with effect from 30 September 2019 as per the decision to the Board Paper (BP)No.723/2019, facilities referred in the decision to the BHRRC paper No.51/2018 cannot be further

Service No	Outstanding Amount as at the Date of Retirement (Rs.)	Retirement Benefit Paid (Rs.)
10290-5	2,641,700	25,220,890
10747-4	4,109,754	17,541,857
10735-9	2,637,298	16,168,890
10738-3	4,874,494	24,332,403
10811-8	2,641,700	17,064,729

Aforesaid loan facilities had been converted in to staff loans through the BHRRC paper No.05/2023 ratified on 27 March 2023. Those loans have been granted at staff loan rate instead of prevailing normal loan interest rate after the date of retirement. Further, tenor of the loans had been extended for a further period contrary to the condition of maximum loan period of five years stated in the offer letter.

III. Through the decision over the Board Paper (BP)No.723/2019 on 30 September 2019, it was decided to discontinue the policy approved under BHRRC paper No.51/2018 and continue the procedure mentioned in the decision to the BP No.723/2019 as the policy towards the disposal of vehicles of the corporate management members. Since the BHRRC paper No.51/2018 discontinued from 30 September 2019, discounting of loan outstanding balance cannot be done and loan outstanding balance should be settled to the Bank. However, as per the details submitted to the audit, below mentioned loans had been discounted at the date of retirement contrary to the above decision.

retirement was discontinued vide BHRRC No. 160/2022. The BHRRC vide 05/2023 granted approval to convert/restructure the vehicle loans granted to corporate management members under the special vehicle loans scheme for corporate management members to the normal vehicle loans scheme for the members of the staff introduced under the staff circular no. 238/90 and its subsequent addenda.

The aforesaid decision was reached having obtained Legal advice and taking into consideration the concerns of the said officers.

The Special Loan scheme approved under BHRRC 51/2018 was discontinued on 30.09.2019 as per BD No.723/2019. However, vide 02/2020 the BHRRC decided that despite the special loan scheme being cancelled, the terms and conditions specified therein were applicable to those who have already obtained facilities under said scheme and authorized the CEO/General Manager to consider proposals in line with the existing policy of BHRRC 51/2018 of the Bank.

Service No.	Approval by CEO/GM
10783	17.08.2020
12289	17.08.2020
11000	09.08.2021
10699	03.12.2020

practiced. As well as, Board Human Resources & Remuneration Committee (BHRRC) cannot exceed the authority vested with Board of Directors (BOD) of the Bank and therefore, any approval granted against the board decision by Board Sub Committee should be referred to the approval for Board.

Further, when formulating policies and approving decisions towards delivering benefits to the employees of the Bank, it is required to ensure that the Bank is at a minimum loss due to those policies and decisions. As well as it is required to strict compliance and consistence apply of policies and decisions towards all relevant employee categories.

Service No.	Retired Date	Balance as at the Retirement Date (Capital) (Rs.)	Amount Waived Off (Rs)
10783	19.06.2020	12,162,449	8,513,714
12289	27.05.2020	12,722,294	6,361,147
11000	09.08.2021	7,145,499	3,572,749
10776	09.04.2020	12,199,380	12,199,380
10697	25.09.2020	11,010,733	7,707,513

Service No. 10763, at his retirement having considered long service and dedicated service decided to release the vehicle bearing No. CAY 6974 BMW530e and to consider allowing a waive off of Rs. 12,512,870.18 plus interest the outstanding balance of the special vehicle loans scheme obtained by him.

IV. Contract basis recruited person - Service No.19596

As per the reply sent by the Bank to the audit query No. BAF/D/PB/2019/E/01, aforesaid special vehicle loan scheme was introduced to the corporate members of the Bank as a solution for low salaries paid to corporate management. However, at the time of granting above loans, a monthly salary around two times had been paid to the above officer as compared with the salary of permanent Senior Deputy General Managers. A special vehicle loan amounting to Rs.18,000,000 had been granted to the above officer (contract basis) on 06 September 2018, where the contract period to be expired on 30 June 2020 (signed on 01 July 2016) who had lesser remaining service period of 2 years as required in aforesaid BHRRC paper.

He has joined the Bank on fixed term contract basis on 01.11.2002 as Senior Dealer which equivalent to a Senior Manager grade of the main banking scheme. The Bank has continued his contracts as Chief Dealer and as Deputy Head of Treasury and new fixed term contract started with him on 16.11.2011 as Head of Treasury and it was continued up to 31.1.2022 and He was absorbed in the permanent cadre as DGM-Treasury.

According to the eligibility criteria of the BHRRC 51/2018 to obtain a special vehicle loan, the applicant should be a member of the Corporate Management with a service of minimum 01 year. By the date of granting Special vehicle loan, Mr. C. Fonseka has continued his service to the Bank as fixed term contract employee for more than 17 years.

V. Former SDGM Strategic Planning – Service No.10702

Special vehicle loan amounting to Rs.20,000,000 had been obtained

As per the BP No. 231/2019, the BHRRC approved following proposals as the appreciation of long-

by the aforesaid officer on 13 September 2018 at an interest rate of 5 percent and retired on 28 March 2019 prior to the age of 60 (six months after the date of loan disbursement). A sum of Rs.2,561,100 from the loan amount had been recovered from the officer for the aforesaid loan prior to the retirement.

- (i) Though balance loan amount had been discounted as per the decision over Bank Human Resource and Remunerations Committee (BHRRC) paper No. 51/2018, the officer had not completed the requirement of minimum period of 2 years from the date of disbursement.
- (ii) As per the BHRRC paper No.51/2018, balance outstanding in the vehicle loan account should be settled by the employee at the time of retirement subject to discount factors. 70 percent discount is applicable for executives with more than 20 years' service in the Bank from which at least 5 years' service in the DGM grade or above. However, by the decision to the Board Paper (BP) No.231/2019, approval of the Board had been granted to transfer the above vehicle at a nominal value of Rs.1 million. Accordingly, a cost of Rs.16,915,442 had been borne by the Bank in the transfer of above vehicle. Details are given below.

standing service rendered to the bank over the years including 8 years in the grade of DGM and SDGM,

1. To release at a nominal fee of Rs. 1 million the vehicle that she has purchased from the staff loan scheme offered by the Bank to the Corporate Management and transfer the mortgage to her.

2. To settle the remaining balance in the said vehicle loan account by way of a grant, superseding the conditions in the vehicle loan scheme for corporate management.

Furthermore, the committee decided to recover outstanding amount by debiting the profit and loss account.

Description	Rs.
Granted amount	20,000,000
Outstanding balance as at the date of retirement	17,915,442
Amount discounted as per BHRRC No. 51/2018 (70% *17,915,442)	12,540,809
Amount to be recovered from the officer	5,374,633
Amount recovered as per the board decision 231/2019	1,000,000
Loss borne by the Bank	4,374,633
Entire write off amount	16,915,442

As per the BHRRC 51/2018, minimum eligibility criteria to obtain a special vehicle loan are, over 05 years of service in the Bank and at least 01 year service as a Corporate Management member and was appointed as a Corporate Management member in 2013.

Noted the comments.

However following to be noted in this regard;

- Approvals of the BOD was taken for the balance outstanding as at March 2020 via BP No 278/2020 (date approved 09.04.2020).
- The outstanding balance of the subject has been waived off on 29.05.2020.

However, as the date of settlement outstanding balance was Rs. 12,199,379.61, due to the repayment of April month installment.

He was granted a sum equal to 05 months basic salary as an appreciation of his service under the approval of BHRRC 400/2020.

VI. Former CEO - Service No.10776

Special vehicle loan amounting to Rs.17,355,429 had been granted to the aforesaid officer on 15 November 2018 at 5 percent rate of interest.

(i) As per the details available, the retirement date was 31 August 2020 at the completion of the age of 60. This doesn't fulfill the minimum service period required to obtain the loan as per the BHRRC paper No.51/2018. However, the officer had retired on 09 April 2020 prior to completion of the minimum period of 2 years specified in the BHRRC paper No.51/2018.

(ii) Approval of the Board had been granted to waive off outstanding balance of Rs.12,512,870 along with the interest of the loan through the decision to the Board paper No.278/2020 on 09

April 2020. As per the memo dated 29 May 2020, addressed to the manager – staff loans unit by the chief manager – finance loan settlement amount was mentioned as Rs.12,199,379.

(iii) As per the decision to the BP No.400/2020 dated 27 May 2020, it had been mentioned that above officer had made a request to the Chairman of Board of Directors to consider granting him the difference of compensation if he had continued to work in the Bank up to retirement date of 31 August 2020. Further, the Board recalled that above officer had been appointed for the post of Adviser to the Ministry of Finance, Economy & Policy Development and resigned from that position and requested premature retirement from the Bank. Accordingly, approval of the Board had been granted to make a full and final compensation payment of Rs.2,911,808 (Basic salary X 5 months) from 09 April 2020 to the retirement date on 31 August 2020.

VII. Former DGM (Recoveries)- Service No.10699

A sum of Rs.17,970,000 had been granted to the aforesaid officer as a special vehicle loan on 11 September 2018 and he was retired on 25 September 2020 at the completion of age 60. Outstanding

The instruction given by BHHRRRC paper No 51/2018 has been supersede by BHRRC121/2020 and has granted approval to consider the period on acting capacity in the grade of DGM as relevant experience in Corporate Management when deciding the discounting rate in releasing the vehicle loan obtained under BHRRC 51/2018.

Even though special vehicle loan under the BHRRC 51/2018 was discontinued under BP 723/2019, it was allowed to continue the same facility for the loans which have already been granted under 51/2018, due to new vehicle disposal scheme introduced under BP 723/2019 was not applicable for Corporate Management members who have obtained loans under BHRRC 51/2018.

balance of the special vehicle loan was Rs.11,010,733 at the date of retirement.

As per the decision of the BHRRC paper No.121/2020, this facility was discounted at the rate of 70 percent by considering acting service period, which was approved on 25 November 2020 subsequent to the date of retirement. However, it was decided to consider the acting service period of the aforesaid officer who retired prior to approval of the said decision. According to the BHRRC paper No.51/2018, acting service period of the corporate level position is not considered in deciding discount rate of the remaining loan balance.

VIII. Following officers are in the service and outstanding balance of the vehicle loans are as follows.

Service No.	Capital O/S as at 30.04.2023 (Rs.)
10692-2	2,641,700
10975-1	5,174,429
12297-8	4,816,969
12443-8	2,935,221

Monthly vehicle allowance of Rs.390,000 for DGMs and Rs.425,000 for SDGMs up to 5 years were approved under BHRRC paper No.51/2018 which consisted from monthly installment of loan, insurance and maintenance. As per the decision to the BP No.723/2019 on 30 September 2019, the policy approved under BHRRC paper No.51/2018 was discontinued. However contrary to the above decision, the vehicle allowances had been paid to the relevant employees as per the details

submitted to the audit.

Approval obtained by BP
487/2019

IX. Former DGM-International Banking
(Service No.10959)

Above officer was retired on 06 March 2019 as a DGM with 29 years of service (along with approximately 03 years' service as corporate member). At the time of introducing new special vehicle loan for the corporate members during the period of 2018, the above officer was not entitled for the said loan scheme as she didn't have minimum of two more years to the retirement. Further, as per the Section 15 – A of amended transport policy of the Bank, approved through the BHRRC paper No.89/2016, a corporate management member who has completed over 7 years confirmed service is given the used vehicle at no cost. However, above officer was not entitled since not fulfilling the minimum service requirement as a member of the corporate management.

CEO/GM (then) has approved to possess the vehicle.

(i) Though above officer had only completed 3 years of service as a corporate member, ownership of the vehicle No. WPCAG -3450 had been transferred at the 50 percent (nonphysical) of the market value as per the decisions given for Board paper Nos.487/2019 and 314/2020.

(ii) Possession of the aforesaid vehicle was with the above officer for the period of one year & 3 months since the date of retirement on 06 March 2019 and the vehicle was formally released on 19 June 2020.

3.4 Human Resources Management

Audit Issue

3.4.1. By analyzing staff cost of the Bank when compare with other banks,

- (i) It was observed that, though the Bank had incurred a cost of Rs.3.61 million per employee per year, the profit generated per employee was only Rs.2.33 million for the year 2022. However, other banks had reported a profit per employee ranging from Rs.2.72 million to Rs.4.49 million per year.
- (ii) Personal Expenses as a percentage of Net Operating Income of the Bank was 34.61 percent for the year 2022 which represented highest value comparing to other banks in the same industry. The ratio of other banks were ranging from 25.90 percent to 32.36 percent during the year under review.

Management Comment

Over the past five years, the bank has witnessed a significant upward in its profits, while concurrently experiencing a decline in its workforce headcount. In response to these trends, the bank has been proactively undertaking initiatives aimed at reducing costs and enhancing operational efficiency. These efforts have been particularly focused on various departments, including Finance, Process Management, and Digitalization. Furthermore, the Human Resources department has taken proactive steps to align with the performance-based incentive system through the Performance Management System in future.

Recommendation

Take necessary actions to effectively use the Bank funds while increasing the efficiency of employees. Further, promotions and recruitments should be transparent and therefore, the Bank should have an approved procedure for the promotions and recruitments of each position and should follow that approved procedure in every promotion without approving Board Papers from time to time.

3.4.2. Recruitments and Promotions

I. Appointment of General Manager (Acting) and Banking Experience of appointed Acting GM

Above officer has joined to the Bank from 01 November 2002 for the post of Dealer on Contract basis and promoted as Chief Dealer with effect from 27 November 2003, Deputy head of Treasury and Investment Banking with effect from 01 July 2007 and Head of Treasury with effect from 02 November 2020. However, this officer has been absorbed for the permanent cadre with effect from 31 January 2022 via decision to the BNC paper No. 01/2022 and BP No. 105/2022. He has been appointed as General Manager (Acting) with effect from 01 January 2023 from the Board meeting held on 23 December 2022. As the CEO/

Due to considerations of risk management and alignment with the 2022-2024 Strategic Plan, the board has decided to introduce new KPIs for the Acting CEO/General Manager. These new KPIs include liquidity ratios, solvency buffer, addressing liquidity shortfalls, and acquiring new corporate clients. The Acting CEO/GM has made significant progress by achieving these KPIs despite challenging economic conditions. During his tenure as Acting CEO/General Manager, the bank was able to drastically reduce the liquidity shortfall and adverse USD and LKR liquidity position effectively. In addition to that the Bank has fully settled all USD obligations in local and foreign

General manager of People's Bank which is one of Largest State Bank of Sri Lanka must play a significantly important role to ensure the Bank's Operations are in line with the expectations of the Financial Market and the economy. Therefore, sufficient experience in overall banking operations is highly applicable to the person who bear the position of CEO/GM of the Bank. Though, above officer has twenty (20) years of experience in the subject of treasury, experience related to other areas of banking was not observed.

banks. Furthermore, in the first quarter 2023 a profit of Rs.2.2 billion has been achieved despite the prevalence of a turbulent economy. Having observed the options available for the appointment of a CEO/GM, the Board of Directors were of the view that Mr. Fonseka was the best available candidate among the banking staff to lead the bank at the moment since he has demonstrated sufficient skills and confidence of his abilities.

In view of the foregoing, the Board unanimously decided to confirm the appointment of Mr.K C J C Fonseka as the CEO/GM of the bank with effect from 01st August 2023 subject to obtaining fitness and propriety of approval of CBSL. Accordingly, letter has been sent to the Director Bank Supervision- CBSL requesting provides their consent to appoint Mr. K C J C Fonseka as CEO /General Manager of the Bank.

II. Promotions to Manager 3-I Grade 2018(2021)

As per Staff Circular Letter No. 8550/2020 dated 20 August 2020, applications had been called to fill 287 vacancies from eligible employees as at 31 December 2019. Accordingly, promotion method and other conditions published through Staff Circular Nos. 300/99 and 300/99(1) were considered for granting promotions for Manager 3-I Grade.

- (i) The above vacancies had been filled based on 30 percent seniority basis and 70 percent written examination basis (category A (50%) & B (20%)). Service period, educational and professional qualifications, interview marks and examination marks for written examination have been considered for selecting

Written examination marks are published on the website of Department of Examinations Sri Lanka and only the candidates will be allowed to search their results individually. Since the audit team has requested the written examination marks, we have already made a written request to the Department of Examinations of Sri Lanka. Interview marks are

suitable candidates for the promotion to the above post. However, though the written examination marks and interview marks had been requested from the Bank, such details have not been submitted to the audit and therefore, transparency of the selection procedure is questionable to the audit.

- (ii) As per the Section 4.8 of Staff Circular Letter No.8550/2020, applicants are allowed to carry forward marks obtained at the written competitive examinations from the previous 10 years. Accordingly, some candidates may sit for several examinations while others may not. Therefore, equal opportunity is not available to candidates for selecting for the above post.

highly sensitive and held at Human Resources Department in safe custody and will be available for audit perusal.

Despite the relevance of Circular No. 444/2018 to promotions for Manager 3-I, the Board of Directors had decided to conduct this promotion based on Circular No. 300/99 on a one-time basis and at the time it was proposed to consider the examination marks of previous 10 years. However currently we adhere with the circular no 444/2018 and as per the 444/2018 (2) 7. (iv) & (v). Earn Marks of the each examination for the promotion to the grades of Assistant Manager, Manager, and Senior Manager can only be carried forward for forthcoming two consecutive rounds of promotions, and also it is essential that, those applicants who intend to carry forward previous examination marks should pass the written competitive examination on the current round of promotions.

III. Promotions to the Assistant Manager 3-III Grade

As per the Staff Circular Letter No.8372/2019 dated 10 June 2019, applications had been called for the promotion to the Grade of Assistant Manager (3-III) from staff assistants who satisfies eligibility criteria as at 31 December 2018 subject to scoring minimum 50 percent for written examination irrespective of cadre

The promotion was called to the grade of Assistant Manager (3-III) under Staff circular No. 300/99. Accordingly, all the employees who had passed the examination were promoted. In here the promotions are non cadre based and it is already mentioned in minute dated on 06/06/2019 under BHRRC Decision 2/2019. However, the continuation of this practice will create a high excess in cadre. To eliminate this, we

requirement. Accordingly, 786 number of employees had been promoted on 15 December 2019, though vacancies were 621 against approved cadre as at 31 December 2019.

adhere to staff circular 444/2018 and will include this in our SOR by 31.03.2024.

3.4.3 Scheme of Recruitment (SOR)

The SOR of the Bank had been approved via Bank Human Resource and Remuneration Committee (BHRRC) paper No. 74/2022 on 08 August 2022. Following observations are made in this regard.

Noted the concern and will take the necessary steps to obtain board approval in future.

I. As per the Section 7 of People's Bank Act No.29 of 1961, the general supervision, control and administration of the affairs of the Bank shall be vested in the Board of Directors of the Bank. However, approval of the Board for the above SOR had not been obtained by the Bank.

Noted the concern and will take the necessary steps to obtain board approval through BHRRC in future incidents.

II. As per Section 4.8 of BHRRC approved SOR, appointing authority will be the BHRRC of the Bank. However, as per the Section 7 of People's Bank Act No.29 of 1961, the general supervision, control and administration of the affairs of the Bank vested with the Board of Directors of the Bank and therefore, Section 4.8 of the above SOR is contradictory with the Peoples Bank Act.

The decision to appoint MSL goes back to the year 2000 with the primary decisioning point being for confidentiality purposes. Whilst the absence of a formal agreement was rectified in 2019, the said agreement has been extended with mutual understanding of either. The formalization of such understanding will be undertaken before December 31, 2023. To save any doubt, MSL is at present paid a monthly fee of Rs. 40,250/- for their services as set out in the said engagement.

3.4.4 Processing the Salary of the Corporate Management Team

I. The Bank has engaged Management Systems (Pvt) Ltd (MSL) for the processing of Senior Executive Payroll originally in the

year 2001 and approved by the Board through the BP No.48/2001. Further, approval has been granted to extend the scope of service of MSL (Pvt) Ltd for the payroll processing of the Bank's entire corporate and executive management. Accordingly, an agreement had been signed on 06 November 2019 for the period of 02 years commencing from 01 January 2018 and it was mentioned that extension for another two years can be made with the consent of the both parties. However, renewals of the agreement for the period up to 31 December 2021(from 01 January 2020) and fresh agreement for the period up to the date of audit had not been furnished to the audit. Hence, it was observed that the payments had been made without any agreement for the period commencing from 01 January 2020 to up to the date of audit on 31 May 2023.

- II. As per the above agreement, the payroll is processed on the basis of the information and instructions given to MSL (Pvt) Ltd by the Bank and information should include cash and non cash benefits provided to employees for computation of PAYE tax, EPF and ETF amongst other. HR division prepares the salary of all other employees of the Bank according to the instructions and the revisions issued from time to time by the Bank. The purpose and the reason for handing over the process to the MSL (Pvt) Ltd has not been mentioned in the Board paper.

- III. Further, according to the details forwarded to the audit, actual number of the corporate and executive management were around 50 officers and Rs. 3,403,955 had been paid by the Bank from year 2018 to 31 May 2023 to MSL for preparation of salary of corporate and executive management.

3.5 Procurement management

Audit Issue

Management Comment

Recommendation

3.5.1. Non availability of Procurement Plan and Action Plan

Though the Bank shall prepare a procurement plan based on action plan as per the Section 8.2 of paragraph 01 of the Bank's Procurement Guidelines, annual procurement plan and the overall action plan were not available for the audit perusal.

Noted the comments.

Actions are being taken to prepare the procurement plan and action plan covering the entire bank from next year onwards. The relevant officers were advised over the requirement to adhere to the stipulated guidelines and the importance of preparing the procurement plan and the action plan covering the entire bank.

Take necessary actions to handle procurement activities effective and efficient way while adhere with established procurement guidelines. Further, Bank should adhere with the national procurement guidelines in the absence of any guidelines in the Bank Procurement Manual.

3.5.2. Method of Procurement

I. Procurement of Pencil Boxes & Instrumental Boxes for Gift Items amounting to Rs. 10,785,000

(i) Without following a suitable competitive procurement method and contrary to the People's Bank Procurement Manual, 37,000 pencil boxes and 70,000 instrumental boxes had been purchased from a private company based on the company's request and the letter submitted by the Prime Minister's Office.

Noted the comments.

The highlighted procurement of pencil cases and mathematical instrument boxes was a one off purchase made under special circumstances.

(ii) Accordingly, though the specifications related to the procurement work shall be reviewed and approved separately by the Technical

Evaluation Committee (TEC) and the Procurement Committee (PC) as per the Section 6.1 (d)(ii) and 3.1(f) of Chapter 02 of the People's Bank's Procurement Guidelines, technical specifications had not been prepared for the Procurement of pencil boxes and instrumental boxes for gift items. Further, as per Paragraph 4 of Chapter 2 of the People's Bank's Procurement Guidelines, procurements above Rs.5 million should be processed through a Procurement Committee. Further, Technical Evaluation Committee (TEC) should be appointed as per Paragraph 6.2 of Chapter 2 of People's Bank's Procurement Guidelines. However, contrary to the above, PC and TEC had not been appointed for the above procurement.

(iii) Project Authorization Request (PAR) had not been prepared and approved which is contrary to the Section 5.4 of Chapter 5 of the People's Bank Procurement Guidelines. Further, bidding documents also not prepared.

(iv) According to the letter submitted by the above company to the Prime Minister dated 29 September 2020 and the physical inspection and inquiries made by the audit on 22 June 2023, it was observed that these orders have been placed on the verbal request of an official attached to the Gampaha Regional Office of the People's Bank. The order was suspended stating that the purchases are being made by the head office. However, above

The procedure manual of the Bank mainly focuses on purchasing goods and other services for the Bank. Hence, the Bank has followed the procurement method which had been applied for developing Strategic Plan 2016-2020, since any internal or external audit/examination had not given any negative comment on this method. Further, Bank has applied a

procurement was made in the year 2021 stating for special deposit mobilization campaign.

- (v) According to the physical inspection and inquiries made by the audit on 22 June 2023, pencil boxes and 6,000 instrumental boxes with the name tag of People's Bank were available for sale at the above private entity. Further, those instrumental boxes had been sold to the public for Rs.290 per box. It is emphasized that, the management of the Bank should prevent the external parties from selling goods with the name of the Bank in public. As well it is required to take necessary legal actions against employees who committed the misconduct.

II. Preparation of Strategic Plan for the period 2021-2023 and 2022 – 2024.

- (i) International Competitive Bidding method or National Competitive Bidding method should be followed by the Bank instead of national shopping since the cost of this procurement exceeds Rs.20 million. National shopping is appropriate for small value of procurement and non-consulting services.

- (ii) As per the Section 05 of Chapter 04 of Bank's Procedure Manual for Procurement, a bid security shall be obtained from all the bidders who are bidding for a project which exceed the cost of Rs.5 million. However, the Bank had not obtained bid

better and transparent method for Strategic Plan 2021-2023 and Request for Proposal has been issued as per the instructions of the Board considering the urgency.

Since there was no bidding process involved, a bid security document was not obtained to develop the Strategic Plan 2022-2024. Further, no bid security document was obtained during the previous instances even though the cost related to the Strategic Plan 2016-2020 was USD 75,200 (Approx Rs.7.17 million)

RFP issuance was initiated during a complete lock down period and it is understood that performance delays are inevitable during a pandemic situation. Further, such clauses could not be justifiable due to the pandemic situation which was prevailing in the country. Moreover, and usually RFPs are not included such a clause, since those invitations are issued for many and such clause is only relevant to the selected party. Also, RFP is not an enforceable legal document as well.

security for this contract according to the said instruction though the cost of contract value is Rs.31 million.

- (iii) As per the Section 7 (j) of Chapter 04 of Bank's Procedure Manual for Procurement, the Bank had not included penalties clause in Request For Proposal (RFP) for delayed performance which help to minimize delays in work done. Due to absence of such clause, Bank was unable to manage the delays of 3 to 4 months of this procurement.