

Central Bank of Sri Lanka - 2023

1. Financial Statements

1.1 Opinion

The audit of the financial statements of Central Bank of Sri Lanka (the “Bank”), which comprise the statement of financial position as at 31 December 2023, and the statement of income, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018, Section 13(1) of the Finance Act, No. 38 of 1971 and Section 101 of the Central Bank of Sri Lanka Act No.16 of 2023. My comments and observations which I consider should be report to Parliament appear in this report. To carry out this audit, I was assisted by a firm of Chartered Accountants in public practice to examine the compliance with International Financial Reporting Standards.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2023, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

1.2 Basis for Opinion

I conducted my audit in accordance with International Standards on Auditing (ISAs). 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 the Governing Board and Those Charged with Governance for the Financial Statements

Governing Board is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as Governing Board determines 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, Governing Board is responsible for assessing the Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process. As per Section 16(1) of the National Audit Act No. 19 of 2018, the Bank 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 Bank.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

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 ISAs 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 ISAs, 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Governing Board.
- Conclude on the appropriateness of Governing Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Bank 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.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the operations of the Bank for the year under review had resulted in a net loss of Rs. 114.4 billion as compared with the net loss of Rs. 374.3 billion in the preceding year, thus indicating an improvement of Rs. 259.9 billion in the financial result. The increase in foreign currency investment income as compared with the previous year was the main reason attributed for this improvement.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income items and major expenditure items of the Bank during the year under review, as compared with the preceding year are shown below.

	2023	2022	Variance [Favorable/(Adverse)]	
	Rs. Bn.	Rs. Bn.	Rs. Bn.	percentage
Income from Foreign Currency Financial Assets	86.2	(135.7)	221.9	163.5
Interest Income	18.0	1.6	16.4	1,025.0
Gain/(Loss) from Unrealized Price Revaluations	29.2	(127.3)	156.5	122.9
Gain/(Loss) from Realized Price Changes	39.0	(10.0)	49.0	490.0
Expenses on Foreign Currency Financial Liabilities	142.6	33.0	(109.6)	(332.1)
Interest Expense	142.5	32.3	(110.2)	(341.2)
Net Foreign Exchange Revaluation Gain/ (Loss)	140.1	(610.1)	750.2	123.0
Total Net Income from Local Currency Financial Assets	(186.4)	437.7	(624.1)	(142.6)
Assets				
Other Income	1.6	2.5	(0.9)	(36.0)
Other Expense	3.5	10.3	6.8	66.0
Operating Expenses	9.8	25.3	15.5	61.3
Tax	-	-	-	-
Profit/(Loss) for the year	(114.4)	(374.3)	259.9	69.4

- (a) The distributable earnings for the year under review as determined in terms of Section 95 of the Central Bank of Sri Lanka Act No.16 of 2023 was negative Rs.313.74 billion as compared with the distributable profit of Rs. 235.03 billion in the preceding year. Due to no distributable earnings in 2023, no transfers are made to the reserves, no recovery of government obligations of Rs.7.4 billion and no transfers to the Consolidated Fund. However, the entire distributable profit in the year 2022 amounting to Rs.235.03 billion had been transferred to the Surplus Account in 2023.

2.3 Trend Analysis of Balance Sheet items of the Bank

- a) According to the annual financial statements of the Bank, the Bank's holding of treasury bills reduced to Rs. 208 billion (Book value) at the end of year 2023 from Rs. 2,480 billion (Book value) stood at the end of year 2022. However, the Bank's holding of treasury bonds increased to Rs. 1,804.2 billion (Book value) at the end of year 2023 from Rs. 17.7 billion (Book value) stood at the end of year 2022. As part of the Domestic Debt Optimization (DDO), the Bank's provisional Advances to the Government of Sri Lanka and Treasury Bills purchased from the Government amounting to Rs.344.7 billion and Rs.2,368 billion respectively were restructured and converted into new Treasury Bonds and Bills with a stepped down coupon interest profile on 21 September 2023. Treasury bills received by the Bank under DDO consisted of a maturity dates varied between February 2024 to September 2024 and Treasury Bonds received consisted of maturities between 6 years to 15 years at step coupon interest of 12.4 per cent until 2024 (including 2024), 7.5 per cent until 2026 (including 2026) and 5 per cent from 2027 until maturity. The above restructure resulted in a day one loss amounting to Rs.766.4 billion as the transaction price differed from the fair value of the new instruments.
- b) According to the annual financial statements of the Bank, the value of foreign assets of the Bank had increased by Rs.712.2 billion or 71.8 per cent to Rs. 1703.6 billion at the end of year 2023 from Rs. 991.4 billion at the end of year 2022. According to the Weekly Economic Indicators published by the Bank, the net foreign assets of the Bank had started to record a negative balance of Rs. 83.9 billion in August 2021. This negative balance had increased to Rs. 1,613.9 billion at the end of December 2022. However, it had decreased to Rs.837.3 billion and to 315.3 billion respectively at the end of December 2023 and April 2024.
- c) According to the Section 39 (b) of the Monetary Law Act (Effective till 14.09.2023), the statutory equity to domestic asset ratio should be 15 per cent. This ratio was 22.7 per cent at the end of August 2023. Further, in terms of the Section 96(1) (b) of the Central Bank of Sri Lanka Act No. 16 of 2023, the sum of the paid up capital and general reserve should be at least 6 percent of the total monetary liabilities of the Bank. The ratio was 6.1 percent as at 31 December 2023 and 22.3 per cent at the end of June 2024.

3. Observations on operational matters

3.1 Payment of Penalty for default in making premium by member institutions of Sri Lanka under Sri Lanka Deposit Insurance Scheme handled by the Bank

Audit Observation	Management Comment	Recommendation
According to the Section 7(iii) of the Banking (Special Provision) Act Direction No. 01 of 2023 dated 15 November 2023, where any member institution makes any default in the payments of premium due, such member institution shall be liable to pay to the Central Bank, a penalty for the period of such default.	It is agreed to include a specified time for paying the penalty by the member institutions of Sri Lanka Deposit Insurance scheme by issuing a new direction under the Banking (Special Provisions) Act No.17 of 2023, considering possible	Need to include a specified time for paying the penalty by the member institutions.

However, a specified time period within losses that can arise to the Sri Lanka Deposit Insurance Fund, due to delays in collecting the penalty.

3.2 Status of Investigation and further actions to be taken of suspended Primary Dealers

Audit Observation	Management Comment	Recommendation
<p>As per the Press Release issued by the Bank on 06 July 2017, the Monetary Board of the Central Bank of Sri Lanka acting in terms of the Regulations made under the Registered Stocks and Securities Ordinance and the Local Treasury Bills Ordinance, had decided to suspend a particular Primary Dealer Company (PD) from carrying on the business and activities as a Primary Dealer for a period of six months with effect from 4.30 p.m. on 06 July 2017. The Monetary Board/Governing Board had granted continuous extensions to the suspension of 15 times in order to continue the investigations being conducted by the Bank. The last suspension is effective for further six months with effect from 05 July 2024. It was stated that as PD had failed to show cause as required by the letter dated 27 December 2017 issued to them and the Chief Executive Officer (CEO) of PD had failed to make himself available for the investigation, the Bank had not been possible to conclude investigation on PD since December 2017. Accordingly, investigations had been delayed for more than six years.</p>	<p>Attorney General's Department, by the letter dated 16.12.2019 has advised that it would be prudent to treat the CEO of PD as a witness, who cannot be compelled to give evidence at the regulatory inquiry at this stage. In addition, by the same letter, the Attorney General's Department has advised that it would be prudent to obtain the CEO's of PD evidence prior to concluding the investigation. Therefore, according to the facts mentioned above, the investigation cannot be concluded until CEO of PD is available to give evidence in the investigation, upon conclusion of the High Court case.</p>	<p>Need to find the ways to conclude the investigation.</p>

3.3 Repatriation of export proceeds of service sector to Sri Lanka

Audit Observation	Management Comment	Recommendation
<p>According to the rules issued by the Bank, in terms of the provisions of the Monetary Law Act/ Central Bank of Sri Lanka No. 16 of 2023, every exporter of goods/or services shall mandatorily receive the export proceeds in Sri Lanka in respect of all goods exported and/or services provided outside Sri Lanka, within 180 days from the date of shipment or provisioning of services, as the case may be. In view of the</p>	<p>The Bank has developed a system named "International Transaction Reporting System" which is used to</p>	<p>Need to introduce a mechanism to fully monitor the repatriation of services export proceeds.</p>

need to efficiently monitor the repatriation of export proceeds in to Sri Lanka, the export proceeds Monitoring System had been launched by the Bank in June 2022 and this system facilitates monitoring of repatriation of export proceeds within the prescribed time period and conversion of export proceeds into local currency. The Bank, Sri Lanka Customs and Authorized Dealers are the three main participants in the system. As export of services is not provided through Sri Lanka Customs, such export proceeds cannot be matched with the information provided by the Authorized Dealers. Accordingly, it was observed that repatriation of service export proceeds is not fully monitored through the above system.

retrieve all relevant statistics relating to foreign exchange inflows on account of services exports.

3.4 Shortage of a Cash Bundle of the Bank

Audit Observation	Management Comment	Recommendation
<p>According to the Press Release issued by the Bank on 20 April 2023, a shortage of a cash bundle worth Rs 5 million (Rs 5,000 denomination) had been discovered in a Vault of the Central Bank during the currency operations on 11 April 2023. An internal probe into the matter was commenced immediately, and a complaint had also been lodged at the Fort Police Station. However, no any party had been detected as being responsible for this Shortage of a Cash Bundle as at 15 September 2024.</p>	<p>The Governor of the Bank requested the involvement of Criminal Investigation Department (CID) in to investigations and detailed findings and actions resulting from the CID investigations are awaited. In addition to the CID investigation, an Internal Fact-Finding Committee has been appointed by the Bank to examine the circumstances and internal processes that led to the shortage, identify any procedural lapses or operational failures, and recommend measures to prevent future occurrences. The committee report will be issued within a one-month period.</p>	<p>Need to implement further safety measures to avoid this type of incident in future.</p>

3.5 Achievement of Inflation Target by the Bank

Audit Observation	Management Comment	Recommendation
<p>According to the Section 26 (1) of the Central Bank of Sri Lanka Act No. 16 of 2023, the Minister and the Bank shall sign a monetary policy agreement with regard to setting out the inflation target to be achieved by the Bank. The Minister of Finance and Governor of the Bank had entered into a monetary policy framework agreement on 03 October 2023 (as published</p>	<p>An inflation target breach would occur if the realized quarterly CCPI-based headline inflation deviates</p>	<p>Suggest to maintain similar position in future as well.</p>

in the Extraordinary Gazette No. 2352/20 dated 05.10.2023) and accordingly, the Bank shall aim to maintain quarterly headline inflation rate at the target of 5 per cent under the agreed monetary policy framework agreement. Further, for the purpose of Section 26(5) of the above Act, the margin is ± 2 percentage points. Accordingly, simple average of the year-on-year percentage changes in the monthly Colombo Consumer Price Index (CCPI) for the three months of the corresponding quarter published by the Department of Census and Statistics for the last quarter of 2023 and first two quarters of 2024 are 2.97 per cent, 4.4 per cent and 1.37 per cent respectively. Hence, it was observed that actual inflation rate was below the target inflation rate during the period from October to December 2023 and April to June 2024. However, as quarterly inflation rate had not deviated from 5 percent by more than ± 2 per cent for two consecutive quarters, an inflation target breach had not happened.

from the 5 per cent target by more than ± 2 percentage points during two consecutive quarters. An inflation target breach has not yet been recorded.

3.6 Progress on Action against persons carrying on Finance Business or accepting deposits without authority

Audit Observation	Management Comment	Recommendation
<p>In terms of the Section 42 of the Finance Business Act, No.42 of 2011 (FBA), for the purpose of ascertaining whether any person has carried on or is carrying on finance business or has accepted or is accepting deposits from the public in contravention of the provisions of Section 2 of the FBA, the Director of the Department of Supervision of Non-Bank Financial Institutions of the Bank or any officer of the Bank authorized on that behalf by the Director may conduct an investigation and for that purpose may do actions as stated in the FBA. According to the information made available, the progress on conducting investigations on complaints received during the years 2022, 2023 and up to 31 July 2024 is as follows.</p>	<p>When conducting investigations, Department of Supervision of Non-Bank Financial Institutions (DSNBFI) experiences significant delays in obtaining required information from the parties subject to investigations as these alleged parties usually attempt to evade their customers as well as regulatory and law enforcement authorities. Finding whereabouts of these parties and obtaining required information is time</p>	<p>Need to find a mechanism to finish the investigations.</p>

	2022	2023	2024 (up to 31.07.2024)
Total number of complaints received	71	128	93
Number of complaints relating to unauthorized finance business/Deposit taking	24	19	11
Number of investigations initiated	24	19	11
*Number of Investigations completed (This includes investigations which have been initiated since 2019)	8	12	4
Total number of pending investigations as at 31 July 2024			122

consuming and create delays. Based on the nature of the investigation, DSNBFI have to engage and coordinate with other law enforcement authorities which usually creates delays in the investigation process. In terms of the Section 59(2) of FBA, the Fund may be utilized for the purposes and in a manner as may be determined by the Board from time to time. Accordingly, DSNBFI may use the funds available in the Fund for public awareness activities conducted by DSNBF, after obtaining the approval of the Governing Board.

According to the above table, it was observed that considerable number of complaints relating to unauthorized finance business/Deposit taking had been received by the Bank during years 2022, 2023 and 2024 (up to 31 July 2024) and majority of investigations are pending as at 31 July 2024.

In terms of the Section 59 of the FBA, there shall be a fund called Enhancing Public Awareness on Financial Matters Fund. Further, all fines received under the FBA shall be credited to the Fund and the money lying to the credit of such Fund may be utilized for the purposes and in a manner as may be determined by the Governing Board of the Bank from time to time. The balance lying to the credit of the above Fund was Rs. 2,795,599 and it had not been utilized during the year 2022, 2023 and till June 2024.