

People's Bank and its Subsidiaries – 2019

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 ("Group") for the year ended 31 December 2019 comprising the statement of financial position as at 31 December 2019 and the statement of income, the statement of comprehensive income, statement of changes in equity and statement of cash flow for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018.

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. My comments and observations which I consider should be reported to Parliament appear in this report.

In my opinion, the accompanying financial statements of the Bank and the Group give a true and fair view of the financial position of the Bank and the Group as at 31 December 2019 and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

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

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

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

In preparing the financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the 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 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 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 Financial Statements

1.5.1 Internal Control over the preparation of financial statements.

Audit Issue	Management Comment	Recommendation
a) During the course of the audit it was noted that the bank does not have documentary supporting to justify the virtual close point.	The virtually close point was arrived at as per the modalities/ mechanisms set by Messrs. Ernst & Young who were the Advisors/ External Consultants engaged for the said matter.	Need to justify the virtual close point with documentary supporting.
b) With the adoption of SLFRS, additional calculations were aroused and the Bank was required to carry out numerous manual works around processes to meet the requirements of new Sri Lanka Accounting Standards (SLFRS). Hence the necessity of a system driven solution or automation is important.	Noted. A more efficient system solution is being looked with a focus on deriving, more importantly, PDs and LGDs. That said, to save any doubt, the data has thus far been processed with less significant errors and without a substantial investment in a system.	Necessity of a system driven solution or automation is important.
c) Following areas related to the Financial Statements Closure Process should be further strengthening.	Noted. Being explored/ in process. Targeted timeline to do so June 30, 2021.	Need to follow up with timeline.
► Automation of preparation of basic level of financial statements.		

- Develop system reports for compilation of risk disclosure notes (e.g.: credit quality, age analysis of Staging, maximum exposure to credit risk, fair value calculations etc.)

1.5.2 Unreconciled Control Accounts or Records

Audit Issue			Management Comment			Recommendation
Following GL accounts are control nature accounts that need to be set off against another account. However, it was observed that no reconciliations were carried out by the bank and hence the balances are getting accumulated. This creates lack of audit trials and increases the risk of fraud.			Following GL accounts are reconciled at September 30, 2020. Reconciled GL Balances of the said accounts were as follows:			Management need to take immediate steps to reconcile these long outstanding balances and recommended to reconcile such GL accounts on time without any delays.
GL No	Descriptions	Amount Rs. Debit/(Credit)	GL No	Descriptions	Amount Rs. Debit/(Credit)	
467401	Payable To Other Bank National Switch Old	405,450,491	397511	S/A Receivable ATM Acquiring – NOV	6,370,400	
495361	Our Visa Debit Card in Other Bank ATM Old	62,951,486	496890	Sus. A/C ATM Acquiring	(912,300)	
496891	S/A ATM Acquiring Visa - Coses Old	885,219,559	495630	Our Master Debit Card In Other ATM	(1,100,660)	
495641	Our Master Card In Our POS Old	14,632	495650	Our Master Debit Card In Other POS	2,252,644	
397512	Other Visa Card In NOVUS ATM'S Old	218,450,365	397460	S/A Receivables From Common EFT System	1,649,193,527	
495631	Our Master Debit Card In Other BN ATM Old	2,936,215	495560	S/A Payable To Common EFT System	(599,049,607)	
397511	S/A Receivable ATM Acquiring - NOV	2,060,445,700	495380	Our VISA Debit Card in other Bank POS	47,002,862	
			Further, to save any future doubt and as a prudent measure, provisions have made for below un reconciled GL balances at 30.06.2020. Notwithstanding, efforts to reconcile/recovery some of the long outstanding continues			

			GL No	Descriptions	Amount Rs. Debit/(Credit)
496890	Sus. A/C ATM Acquiring	(1,903,387,509)			
495630	Our Master Debit Card In Other ATM	17,934,577	467401	Payable To Other Bank National Switch Old	405,450,490
495650	Our Master Debit Card In Other POS	41,302,054	495361	Our Visa Debit Card in Other Bank ATM Old	62,951,485
397460	S/A Receivables From Common EFT System	5,166,211,505	496891	S/A ATM Acquiring Visa - Coses Old	1,034,685,950
495560	S/A Payable To Common EFT System	(4,415,631,281)	495641	Our Master Card In Our POS Old	16,222
495380	Our Visa debit card in other bank pos	(158,018,036)	397512	Other Visa Card In NOVUS ATM'S Old	218,450,365
495371	Our Visa debit card in our pos old	(1,627,684)	495631	Our Master Debit Card In Other BN ATM Old	2,936,214
495372	Our Visa debit card in our pos mismatches	(109,338)	495371	Our Visa debit card in our pos old	(1,627,684)
495642	Our Master debit card in our pos mismatches	(46,221)	495381	Our Visa debit card in other bank pos old	875,521
495381	Our Visa debit card in other bank pos old	875,522	394544	Receivable from other bank NSWITCH NOVOU old	41,457,150,800
394544	Receivable from other bank NSWITCH NOVOU old	41,457,150,800	394545	Receivable from other bank NSWITCH NOVOU old	(41,592,628,390)
394545	Receivable from other bank NSWITCH NOVOU old	(41,592,628,390)	495591	S/A ATM acquiring Master- cases old	(961,615,530)
495591	S/A ATM acquiring Master- cases old	(961,615,530)	397573	Other Master card in Novus ATM old	(123,500)
397573	Other Master card in Novus ATM old	(123,500)			

1.5.3 Suspense Accounts

Audit Issue	Management Comment	Recommendation										
a) "Suspense A/C – Alteration to premises" maintains to record amounts/advance paid in relation to alteration of premises .Once the alteration is completed and final payment is made, it will be capitalized or expensed depend on the nature of the alteration. It was observed that there are number of advances remain in this account without being cleared.	Efforts will be made to resolve on or before December 31, 2020.	Need to take actions to resolve outstanding balances.										
b) "Suspense Account -Money Retention O/A Contra Perform" consists of long outstanding payable balances of retention amounts on the Constructions & Repairs. Age Analysis is as follows.	Noted. Contractors will be informed to take necessary actions to clear the balances with a target to do so on or before March 31, 2021.	Need to take actions to clear the long outstanding balances.										
<table border="1"> <thead> <tr> <th>Year</th> <th>Amount (Rs.)</th> </tr> </thead> <tbody> <tr> <td>0 -3</td> <td>43,210,781</td> </tr> <tr> <td>3 -6</td> <td>3,382,465</td> </tr> <tr> <td>6 -9</td> <td>35,119,130</td> </tr> <tr> <td>Over 9</td> <td>357,354</td> </tr> </tbody> </table>	Year	Amount (Rs.)	0 -3	43,210,781	3 -6	3,382,465	6 -9	35,119,130	Over 9	357,354		
Year	Amount (Rs.)											
0 -3	43,210,781											
3 -6	3,382,465											
6 -9	35,119,130											
Over 9	357,354											

1.6 Accounts Receivable and Payable

1.6.1 Advances

Audit Issue	Management Comment	Recommendation																														
a)The total outstanding Capital and interest amount of top 20 Non-Performing customers was Rs. 20,367.24 million and Rs.26, 039.59 million as at 31 December 2019 respectively and it represents 22.34 per cent of total non-performing loans and advances of the Bank as at that date. Details are given below.	Confirmed.																															
<table border="1"> <thead> <tr> <th>No</th> <th>Name of the Customer</th> <th>Capital Balance</th> <th>Interest Balance</th> <th>Total Balance</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>CML Group</td> <td>3,450.98</td> <td>590.29</td> <td>4,041.27</td> </tr> <tr> <td>2</td> <td>Yashoda Group</td> <td>3,030.44</td> <td>20,167.20</td> <td>23,197.64</td> </tr> <tr> <td>3</td> <td>W M Mendis and Company Ltd</td> <td>2,569.13</td> <td>105.42</td> <td>2,674.56</td> </tr> <tr> <td>4</td> <td>Mihin Lanka(Pvt) Ltd</td> <td>2,556.92</td> <td>311.35</td> <td>2,868.27</td> </tr> <tr> <td>5</td> <td>Huravee Int'l (Pvt) Ltd</td> <td>1,723.14</td> <td>203.43</td> <td>1,926.57</td> </tr> </tbody> </table>	No	Name of the Customer	Capital Balance	Interest Balance	Total Balance	1	CML Group	3,450.98	590.29	4,041.27	2	Yashoda Group	3,030.44	20,167.20	23,197.64	3	W M Mendis and Company Ltd	2,569.13	105.42	2,674.56	4	Mihin Lanka(Pvt) Ltd	2,556.92	311.35	2,868.27	5	Huravee Int'l (Pvt) Ltd	1,723.14	203.43	1,926.57		
No	Name of the Customer	Capital Balance	Interest Balance	Total Balance																												
1	CML Group	3,450.98	590.29	4,041.27																												
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6	Good Fellows (Pvt) Ltd	996.70	745.89	1,742.59
7	Daya Apperal Group	767.57	17.92	785.50
8	Lankem Ceylon PLC	724.81	126.75	851.56
9	Rican Lanka (Pvt) Ltd	721.27	1,216.19	1,937.46
10	Nawaloka Group	564.05	6.23	570.28
11	State Engineering Corp of Sri Lanka	416.84	10.20	427.04
12	V V Karunaratne and Company	408.69	17.84	426.53
13	Ruhunu Development Contractors	403.25	26.10	429.35
14	Ruusirumal (Pte) Ltd	377.34	196.31	573.66
15	Grayline Rayline International (Pvt) Ltd	351.03	1,862.58	2,213.61
16	Lak Steel ENgineering (Pvt) Ltd	343.97	1.54	345.51
17	E W Information Systems Ltd	302.17	366.03	668.20
18	Adam Carbons (Pvt)Ltd	251.24	34.37	285.60
19	Kamal Group	210.89	33.34	244.23
20	N & A Engineering Services (Pvt) Ltd	196.80	0.61	197.41
	Grand total	20,367.24	26,039.59	46,406.82

- b) The total outstanding Capital and interest amount of top 20 Non-Performing customers granted and transferred to Non Performing during the year 2019 excluding restructured/Rescheduled loans was Rs. 2,249.16 million and Rs.54.87 million as at 31 December 2019 respectively and it represents 2.48 per cent of total non-performing loans and advances of the Bank as at that date. Details are given below.

Confirmed.

Rs.Mn

No	Name of the Customer	Capital Balance	Interest Balance	Total Balance
1	Olympus Construction Pvt Ltd	634.00	7.37	641.37
2	Lak Steel Engineering Pvt Ltd	398.13	1.54	399.66
3	W M Mendis & Company Ltd	288.45	6.38	294.83
4	Nawaloka Steel Industries (Pvt) Ltd	231.05	1.01	232.06
5	Daya Apparel Export (Pvt) Ltd	108.58	5.58	114.15
6	CML Group	122.10	15.22	137.33
7	Lankem Ceylon PLC	58.51	6.96	65.47
8	G Muthumala Motor Stores Colombo Pvt Ltd	55.88	2.29	58.17
9	Electro Metal Pressings Pvt Ltd	52.73	0.29	53.03
10	State Engineering Corporation of Sri Lanka	50.00	0.48	50.48
11	L and C Packaging Industries (Pvt) Ltd	42.19	0.55	42.73
12	U S S Engineering (Pvt) Ltd	39.70	0.06	39.76
13	Rajah	38.74	3.19	41.92
14	Nawaloka Petroleum Pvt Ltd	35.72	0.25	35.97
15	Ceyland Enterprises Pvt Ltd	31.10	1.16	32.26
16	Aura Farming Exports (Pvt) Ltd	23.94	0.42	24.37
17	Commercial Fiber Export Pvt Ltd	18.40	0.41	18.81

18	Nishanthas Glass Marketing Services	11.75	1.17	12.92
19	Duminda Builders Pvt Ltd	8.20	0.54	8.74
20	Premium International	8.38	0.83	9.21
Grand Total		2,257.54	55.71	2,313.25

- c) The total outstanding Capital and interest amount of top 20 Non-Performing customers restructured/rescheduled and transferred to Non Performing during year 2019 was Rs. 1061.47 million and Rs.16.13 million as at 31 December 2019 respectively and it represents 1.16 per cent of total non-performing loans and advances of the Bank as at that date. Details are given below. Confirmed.

No	Name of the Customer	Capital Balance	Interest Balance	Rs.Mn Total Balance
1	N and A Engineering Services Pvt Ltd	331.80	1.04	332.84
2	Kotagala Plantations PLC	262.52	11.07	273.59
3	W M Mendis & Company Ltd	144.00	0.65	144.65
4	Nawaloka Steel Industries (Pvt) Ltd	140.98	0.50	141.48
5	V V Karunaratne and Company	37.33	0.29	37.63
6	Shirani Manel	18.60	0.09	18.69
7	Selikno Holdings Pvt Ltd	15.00	0.21	15.21
8	KMC Constructions Lanka Pvt Ltd	13.75	0.35	14.11
9	Dissanayake	11.81	0.52	12.33
10	Alft Packaging Company (Pvt) Ltd	11.69	0.03	11.72
11	Chaminda Cushion Works Pvt Ltd	10.07	0.13	10.19
12	K P Projects International (Pvt)Ltd	8.77	0.02	8.79
13	Rukman Holdings Pvt Ltd	7.95	0.29	8.24
14	Saravanan	7.92	0.18	8.10
15	Wickramasinghe	7.80	0.12	7.93
16	Fareed	7.66	0.08	7.75

17	L and C Packaging Industries (Pvt) Ltd	6.76	0.03	6.79
18	Dias	5.91	0.07	5.98
19	Kusumsiri Darmappriya	5.58	0.08	5.67
20	Nishanthas Glass Marketing Services	5.55	0.37	5.92
Grand Total		1,061.47	16.13	1,077.60

d) Different credit packages were granted to MTD Walkers PLC and its subsidiaries with the Board approvals during the period of Group Deputy Chairman holding a directorship of the Bank's Board. However loans under the aforesaid credit package were transferred to Non Performing category and balances outstanding as at 31 December 2019 is as follows.

Name of the Borrower	Total Granted Amount (Rs)	Total Outstanding as at 31/12/2019 (Interest, Penal & Other)
Walkers Equipment (Pvt) Ltd	298,630,006	362,860,136
Walkers Sons & Company Engineering (Pvt) Ltd	Approved 265,000,000	35,042,697
Walkers Pilling (Private) Limited	570,832,140	565,174,225
CML MTD Construction Ltd	2,762,727,041	3,278,147,582
Total		4,241,224,640

It was further observed that, since these loans had been granted without obtaining adequate strong securities and with certain lapses, the recoverability is in doubt.

As per the approved credit package, short term loan facilities should be repaid within maximum of 180 days from the date of grant. However it was observed that some loans were extended when they reached to the NPL status with the board approvals.

e) The total outstanding balance from Duro Pipe Industries under loan number 48001000004683 and 48001000007877 was Rs.162.087 million as at 31 December 2019 and the loans were transferred to non performing category on 22 February 2012. Even the bank had received the judgment in favorable to the bank against the case CHC 269/2013, bank had not yet recovered the outstanding loan balance.

The company defaulted the judgement and accordingly, the bank was allowed to execute writ against the assets mortgaged to the Need to follow up recoveries.

bank. However, execution of the assets was delayed upon confirmation given by chairman of the group of companies.

According to him, he has entered into agreement with the State Mortgaged Bank to sell a property belongs to him and upon which the entire settlement will be effected by the officials of the State Mortgaged Bank. Further the chairman of the group recently informed the bank re-progress of the Cabinet approval regarding this transaction.

f) The total outstanding balance from particular corporate customer under loan number 48001000002934 was Rs.367.862 million as at 31 December 2019 and the loans were transferred to non performing category after serviced three months from granted date which was on 29 April 2009. It was further observed that this facility was pledged against personal guarantees of the directors which was not yet recovered as at 31 Dec 2019.

The bank filed the Commercial High Court Case No. CHC 571/MR and successfully concluded case. The case is schedule for their objections.

Need to follow up recoveries.

g) The total outstanding balance from particular corporate customer under 29 numbers of facilities were Rs.1009.363 million as at 31 December 2019 and the loans were subsequently transferred to non performing category. The aforesaid facilities were pledged against of which the bank holds the secondary mortgage over the Matale property and primary mortgage over the Borella property where considerable portion of the liability was not secured and backed by personal guarantees of the directors and the corporate guarantee of the related company of EWIS.

Litigation procedures has already been initiated against the Personal Guarantee of the directors of EWIS and Corporate Guarantee of Toppan Forms (Colombo) Limited, a related company of EWIS.

Need to consider adequate and strong securities for loan granting, in order to prevent them from transferring into non-performing category.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
a) Direction no. 3(5)(1) & 4(4) issued by Central Bank of Sri Lanka (CBSL) and General circular no:734/2005 and section 5.7 of the Recovery manual issued by the Bank	Loan should be categorized as Non-performing loan when 3 consecutive installments have not been paid before and after rescheduling. Certain instances of non compliance were observed. As a example total loan amounting to Rs.1670.881million granted to Grand Mountain Hotel (Pvt) Ltd under loan numbers 28001000013657,28001000013684,28001000012569,280010000108014 and 21001000142922.	This is under development stage. Target is to resolve by June 30, 2021.	Recommend to resolve within target time.
b) General Instruction Circulars 612/96(1)	Staff rotation must be placed as to avoid any disorganization of the branch staff and rotation cards must be maintained properly. However in certain instances where the bank had not followed the said instructions were identified.	Deficiencies rectified. A specific instruction in this connection was sent to the Branch Manager on September 24, 2020	Need to be strictly adhering with the instructions given in the circular.
c) General Instruction Circulars 808/2009, Section No. 3.17	The bank should transfer employees who had been on one place for more than four years as an internal control methodology. It was observed that some officers are engaged in same branch for more than four years.	Deficiencies rectified. A specific instruction in this connection was sent to the Branch Manager on September 24, 2020.	Need to be strictly adhering with the instructions given in the circular.
d) Section no: 3.1 of Manager's Circular No. 581/2004(68)	When granting facilities Branch Managers should ensure that their Loan portfolio is increased in a qualitative manner and periodical close monitoring of branch managers is required with proper administration. However in an inspection of the Liberty Plaza branch, it was observed that the bank had failed to follow	Noted. A series of credit training programs, including legal officer training, were carried out, and will be continued to be carried out with the aim if further reinforcing the Bank's existing credit	Need to be strictly adhering with the instructions given in the circular.

such instructions with regarding policies and to the OD number guidelines. 309100122536237 and loan number 3098101000022129.

- e) **Public Enterprise** **Circular No PED 03/2016 dated 29 April 2016 Paragraph (2)**
- PAYE Tax of public officers including employees of state owned enterprises should be deducted from tax liable employee earnings as per the relevant regulations of the IRD. However, the collective agreement signed between the Bank and People's Bank's employee union directs to pay the income tax liability of the employees by the Bank without being deducted from the employees' salary. Based on that, the Bank has paid Rs.267,841,052 as PAYE tax on behalf of employees for the year ended 31 December 2019, without deducting from employee's earnings.
- PAYE tax being borne by the Bank has been a permanent fixture in the collective agreements entered into between the State Banks and the respective Trade Unions for over two decades
- As per the last executed collective agreement - as applicable to the period from January 1, 2018 to December 31, 2020 - this is dealt with under section 6
- The collective agreements for all State Bank(s) are identical. As a general matter, peer Banks obtain the clearance/ concurrence of the Ministry of Finance prior to executing/ effecting the said agreement(s)
- Ensure compliance with the instructions issued under PED circular No.03/2016.

1.8 Cash Management

----- Audit Issue -----			Management Comment -----	Recommendation -----
During the review of Cash in Hand GL accounts, it was noted that some GL accounts consist of negative balances due to erroneous posting of entries.			- GL CODE-300000 - Cash in hand	Need to take corrective actions and implement proper review process on such accounts.
GL Code- 300000	Branch	Amount (Rs) as at 31-12-19	39- Kaluthara: Above credit balance is in 300000-EUR GL. E/C entries made on 11/02/2020.	
39	Kalutara	(1,568,626)	236-Maradana : Above credit balance is in 300000-USD GL. E/C entries made on 14/10/2020.	
236	Maradana	(109,374)		
Total		(1,678,000)	- GL CODE-300020 - Cash in hand - Central Switch - Coses	
GL Code- 300020	Branch	Amount (Rs) as at 31-12-19	- GL CODE-300021 -Cash in hand - Central Switch – Novus	
113	Batticaloa Town	(278,400)	Proper ATM reconciliation mechanism has introduced to reconcile 300020- Cash in hand - Central Switch - Coses and 300021- Cash in hand - Central Switch – Novus GL’s. Above correction entries will be passed before December 31, 2020.	
128	Rattota	(3,762,700)		
190	Kaluwanchikudy	(165,100)		
316	Ragama	(14,200)		
Total		(4,220,400)		
GL Code- 300021-	Branch	Amount (Rs) as at 31-12-19	- GL CODE-300120 - CASH IN HAND - MINI SCHOOL BANK	
51	Kahatagasdigiliya	(8,315,800)	GL outstanding has now been reduced from Rs.34,025 to Rs.3,897. Corrective measures are taken to rectify the balance outstanding.	
69	Mawanella	(1,670,900)		
81	Ruwanwella	(416,500)		
194	Kolonnawa	(9,613,800)		
236	Maradana	(641,700)		
Total		(20,658,700)		
GL Code- 300120-	Branch	Amount (Rs) as at 31-12-19		
3	Kandy	(31,740)		
70	Matugama	(190)		
86	Thimbirigasyaya	(120)		
236	Maradana	(1,975)		
Total		(34,025)		

1.9 IT General Controls

Audit Issue	Management Comment	Recommendation
(a) During the review on 20 January 2020, it was observed that certain user accounts are duplicated and remained active in the SIBS system.	Requisite corrective measures are currently in process.	Need to implement proper process to prevent duplication of user accounts.
(b) During the review, it was noted that some of generic user accounts exist in the Prime 4 system, where the description in the "Username" cannot be identified with a specific individual of the organization.	Even they are using generic user accounts, details of these user accounts are mentioned in the user creation forms. Also, they are connected to the prime 4 system in active directory environment. Currently, the Bank is in the process of removing generic users by providing named users to particular systems.	Need to ensure not existing of generic user accounts.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit before tax of Rs.19.666 Billion and the corresponding profit in the preceding year amounted to Rs.24.406 Billion. Therefore a deterioration amounting to Rs.4.74 Billion of the financial result was observed. The main reasons for the deterioration are the increase of Bank's impairment charges by 121 percent and decline of foreign exchange gain by 87 percent during the year under review.

2.2 Trend Analysis of major Income and Expenditure items

2.2.1 The following table summaries the financial results of the Bank in the year under review and the preceding four years period.

Year	2019	2018	2017	2016	2015
Interest Income (Rs. Mn)	184,025	166,441	149,184	109,970	92,486
% of Increase/(Decrease) compare to the preceding Year	10.56	11.57	35.66	18.9	
Interest Expenses (Rs. Mn.)	125,508	111,035	98,719	66,846	48,732
% of Increase/(Decrease) compare to the preceding Year	13.03	12.48	47.68	37.17	
Profit Before Tax (Rs.Mn)	19,666	24,406	25,913	20,814	19,520
% of Increase/(Decrease) compare to the preceding Year	(19.42)	(5.82)	24.5	6.63	

2.2.2 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 Increase/ (Decrease) (Rs'000)	Variance %	Reason for the Variance
Interest Income	17,583,630	11	Interest income on debt instrument measured at amortized cost has been increased by 54 per cent (7 billion) due to increase in investment of Sri Lanka Government Securities. Interest income on loans and advances to other customers has been increased by 7 per cent (9 billion) mainly backed by increase in term loans, overdraft and pawning.
Interest Expense	14,472,777	13	Deposit base has increased by 68 billion by end of 2019 showing a 5 per cent growth rate.
Other Expenses	1,831,502	12	Depreciation and amortization charge has increased by 126 per cent due to incurring of cost of amortization of right to use assets amounted to 1.9 billion incurred in 2019 according to SLFRS 16.
Impairment Charge	3,174,676	121	Non-performing of loans and advances to other customers have been increased by 1.95 per cent by following similar situation of the whole industry.
Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Repayment Levy (DRL) on financial services	1,364,523	18	Total value addition prior to VAT & NBT has increased due to increase of interest income by 11 per cent in 2019.

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	
		2019	2018
Performance Ratios			
Return on Equity (ROE)	10.6	13.9	20.3
Return on Assets (ROA)	1.0	1.1	1.5
Interest Margin	3.6	3.2	3.5
Assets Quality Ratio			
Gross Nonperforming Advances (NPL)	4.6	3.3	2.5
Capital Adequacy Ratios			
Tier 1 Capital(Minimum 10%)	13.0	10.7	11
Total Capital(Minimum 14%)	16.6	14.7	14.5
Statutory Ratio			
Liquid Assets Ratio (Minimum Requirement 20%)	27.8	21.7	27.6
Liquidity Coverage Ratio (Minimum Requirement 100%)		Rupee - 160.80 All currency - 132.10	Rupee - 144.90 All currency - 100.42

3. Operational Review

3.1 Uneconomic Transactions

Audit Issue	Management Comment	Recommendation
a) According to the Board Human Resources and Remuneration Committee (BHRRC) paper no.51/2018, BHRCC had approved the new vehicle loan scheme with vehicle allowance to the Senior Deputy General Managers(SDGMs) and Deputy General Managers(DGMs) on 10 October 2018.However it was observed that the bank had implemented the loan scheme without obtaining prior approval of the Board and subsequently the board had ratified the decision on 17 May 2019.Prior to the date of Board ratification the bank had issued 10	Since this is a loan scheme relating to staff welfare, the BHRRC has granted approval within its authority and subsequently Board ratification has been obtained. Prior to implementation of this loan scheme, maintenance and administration of the Bank's vehicle fleet of Corporate Management was done by the Bank. Upon implementation of the loan scheme, vehicle administration &	Noted and need to be reconsider whether objective of loan scheme can be realize through adding loan installment as allowance due to ownership retained with themselves.

number of loans amounting to Rs.183.29Million to SDGMs and DGMs. According to the aforesaid paper, objective of the introduction of new loan schemes for SDGMs and DGMs is to reduce the cost of ownership, the maintenance and to encourage and facilitate executives to own their official vehicle.

However the aforesaid new loan scheme itself contradicts to its objectives since it offers the loan installment, insurance and the maintenance cost of the vehicle. Further the loan installment had been added to the salary of the particular employee as an allowance by the bank which means the entire facility is giving free of charge.

Further to above eligibility criteria is only to the executives who should have at least 2 years service period left prior to retirement/contract expiry, however the bank had granted this facility to executives who bearing service numbers 107763,107474 and 107839 without comply to the aforesaid new loan scheme.

maintenance was handled by the senior executives themselves, saving the staff cost for salary and overtime whereas involvement of the Bank in fleet administration was not necessary thereafter.

The vehicle installment was calculated considering all these scenarios including insurance & maintenance etc, which are to be incurred by the senior executives.

Difference between loan installment and allowance paid to executives is between Rs.2.8 Mn to Rs.3.0 Mn for five years or Rs.580,000/- to Rs.600,000/- per year. Out of this amount, executives need to pay for the Insurance in between Rs.230,000/- to Rs.250,000/- per year, Luxury tax of Rs.60,000/- to Rs.40,000/- per year. Service of the vehicle Rs.40,000/- to Rs.50,000/- per each service (2 - 4 services per year) and expenses for this were there such as mechanical faults and replacing tyres etc.

The above loan scheme was introduced to replace then practice of providing vehicles for the senior executives. Under the previous practice, bank used to maintain the vehicle provided to the executives who had the opportunity to purchase same at concessionary rate. Under the new loan scheme (51/2018) the executive should continue using the vehicle even after the loan tenure of 5 years. After the loan tenure, only a monthly maintenance allowance of Rs.100,000/- is paid. Executive is eligible to obtain loan once in every ten years.

As per the meeting held on 10th October 2018 and the relevant minute dated 7 November 2018, a decision has been made by the BHRRC that considering the long and dedicated service the opportunity should be given to the above 03 senior executives, to obtain vehicle loans under the loan scheme approved vide BHRRC NO.51/2018, although any of them does not have 02 years ahead to serve the bank and that the vehicles already used by them were purchased by the Bank about one year ago.

3.2 Management Inefficiencies

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
It was observed that the vehicle bearing No.CAI 4646 owned by the bank is using by the former Chief Executive Officer (Contract No.50404) without being handing over to the bank from 15 April 2019. As they are the assets of the Bank, fully owned by the government it may lead to misuse of public assets. This vehicle was released without obtaining the prior approval of the Board and subsequently ratified by the Board held on 09 April 2020 via Board Paper No.315/2020.	The Bank is currently in the process undertaking requisite corrective measures in consultation/ coordination/ guidance of the Central Bank of Sri Lanka.	Need to be follow up the process on corrective measures.

3.3 Operational Inefficiencies

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
a) Non-performing Loan balances of top 50 credit cards belongs to non-staff were Rs.47,974,396 as at 15 May 2019. In the sample audit it was observed that, out of above 50 cardholders most of the cards had enhanced up their credit limit subsequently. The above credit accounts had been transferred to non-performing category due to irregular payment. In certain instances the bank had not taken the approval and not presented any documents to prove the income and repayment capacity of the customer	The Bank has taken all possible recovery actions efficiently and effectively based on G I No 734/2005 circular instructions on recover procedures.	Need to follow-up the recovery actions.

thereon. It was further observed that the bank was unable to hand over summons to relevant customers due to vacated from the given address, not residence at given address etc. with regarding to the non performing customers. Thereafter no any recovery actions were observed at satisfactory level.

b) Although following non performing facilities were rescheduled in several times, it was observed that customers were defaulted subsequently.

Loan Numbers	Branch	Granted Amount Rs.
Kotagala Plantation	Head Quarters	511,000,000
Rathnaloka Tour Inns	Head Quarters	16,900,000
Micro Enterprises	Sea street	75,681,418
Ampere Electric (Pvt) Ltd	Sea street	22,990,237

A re-schedulement does not invariably guarantee a transition to performing which ultimately is a function of the borrower continuously being able to abide by the new/ rescheduled terms. To save any doubt, as per CBSL direction 3 of 2008, a rescheduled facility will only be transferred to performing is the borrower either pays the interest and/ or capital in arrears in full or if six months dues as per rescheduled terms are consistently met without exception.

Need to give more concentration on such customers, prior to approve the new reschedulement over such facilities.

3.4 Delays in Projects or Capital Work

Audit Issue	Management Comment	Recommendation
Although amount of Rs.565,445,424 was incurred as an expense for the construction of proposed Head Office Building at Hyde park Corner during the year 2017 to 2019, it was temporarily suspended and not yet completed up to now.	The temporary suspension was in view of re-assessment undertaken more so circumstances/ developments considered. The Bank has made a request to acquire the said land from the Urban Development Authority (i.e. which is currently under a 99 year lease). All else permitting, work is expected to resume in the near term.	Need to followup.

3.5 Procurement Management

Audit Issue	Management Comment	Recommendation
<p>Digitalization project had been awarded to Silverlake Company who is the current supplier of Core Banking at a cost of USD 11 Million. As per commercial proposal, USD 7.6 Million and USD 3.4 Million out of aforesaid cost was approved to Silverlake Digital Economy for Digitalization and to Silverlake Sprint for core banking upgrade respectively. Further the bank had awarded a tender to Just In Time Technologies (Pvt) Ltd for purchase of hardware for this project at a cost of USD 3.3137 Million. According to the analysis of payments it was observed that additional payments were made time to time based on the change requests made to the modules include in aforesaid project. Furthermore it was observed that there was no any reliable supporting documents to prove the additional payment of Rs.84,631,716 made to the Just in Time in addition to the agreed cost for hardware purchasing. Hence no evidence was available to prove the relevancy of this expense on this project. Furthermore these additional payments included the tax paid at 10 percent according to the section 94 of the Inland Revenue Act No.10 of 2006 which have to be paid by Silverlake Company on their profit/income derived from Sri Lanka, as a result of the bank had already signed the agreement including a condition to bear by the bank. This is the amount which had to be deducted from their payment and remit to the Inland Revenue Department which is not really a liability to the Bank. According to our calculation, total additional amount paid for the project was Rs.452,725,561 (excluding annual maintenance charges) as at 26 August 2019.</p>	<p>This payment is for the purchase of Hardware for Digital Banking Project which had been made with the approval of B P No. 301/2016 and which had been ratified by B.P No. 63/2017. Change requests arise when the initial scope of User requirements deviate from the present, new User requirements where relevant software/programmes have to be changed/enhanced.</p> <p>The payment was made based on a original Board of Directors approval of January 26, 2018 (BP No 68/2018) and a subsequent approval/ ratification on March 19, 2020 (BP No 149/2018) and considering a Payment Request Form duly signed by the Head of the Payment originating department in accordance with circular 708/ 2006, as accompanied by an invoice cited as being checked and certified by the Assistant General Manager (IT) and Head of IT and an instruction to pay by the Deputy General Manager (Banking Support Services) on April 6, 2018, a (re) validation of the said invoice by the Head of Information Technology on April 9, 2018 and ultimately an instruction by the Chief Executive Officer/ General Manager to pay based on the Board approved minute and Head of IT validated invoice on April 11, 2020</p> <p>The payments have been made as per the signed agreement's Terms and Conditions. Bank made</p>	<p>Need to ensure all the expenses supported along with the relevant documents that can be verifiable by third party. Further relevancy of expenses should be able to establish.</p>

several attempts to negotiate with the Vendor in this regard; however, they did not agree to deduct the 10%, WHT and remit the amount.

3.6 Human Resources Management

Audit Issue	Management Comment	Recommendation
<p>Although the COPE meeting held on 17 July 2018, directed the CAO/AO not to extend the service period of the former Chief Executive Officer after the age of 60 years, the Bank had extended an additional six months service period to him after completion of 60 years of age. With the service extension of six months period bank had incurred a cost of Rs.15,410,266.45 as salary for him.</p>	<p>Noted. The extension was granted based on an approval as received from the Ministry of Finance on 02/10/2018. The Bank has taken measures to ensure non repeat since without any exception whatsoever. The age of sixty has been strictly re-enforced for all who retired thereafter.</p>	<p>Need to adhere with relevant regulations..</p>