

People's Bank and its subsidiaries - 2020

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 ("Group") for the year ended 31 December 2020 comprising the statement of financial position as at 31 December 2020 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.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 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 2020, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

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

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

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

In preparing the financial statements, management is responsible for assessing the Bank's and 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 Audit Scope

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

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

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

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

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the 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 Audit Observations on the preparation of Financial Statement

1.5.1 Suspense Accounts

Audit Issue -----	Management Comment -----	Recommendation -----
a) Suspense A/C – Amount paid to suppliers on pending delivery Accumulated balance amounting to Rs.1,643 Mn was remained in outstanding more than two years without clearing.	Noted. The matter is being looked with a target to resolve before September 30, 2022.	Need to be carry out proper assessment on such balances and clear them earliest.
b) Suspense A/C-Money Retain O/A Contra Perform The balance of Rs.22.6 Mn or 40 percent, from the total balance of Rs.56.3 Mn was remained in outstanding for more than 3 years period.	Noted. Necessary arrangements have been made to inform the contractors. Target is to clear before December 31, 2022.	Need to be clear earliest.

1.6 Related Parties and Related Party Transactions not disclosed

Audit Issue -----	Management Comment -----	Recommendation -----
a) The Bank needs to strengthen and monitored the process over updating details of close family members of the Key Management Personnel and their related entities.	Process to capture RPT transactions has been further strengthened now and all submission related to the RPT disclosures are submitted through DGM (Compliance) and Board Secretary. Disclosures related to the Related Party Transactions in terms of	Actions should be taken to disclose related party transactions covering the requirements under different frameworks/rules specially with the enactment of National Audit Act.
b) At present, the Bank has not in placed a process to flag all the	Direction 3(7)(i) of Banking Act	

related party transactions carried out through the core banking system.(Tracking and extract of related party transactions) Direction have been made via Quarterly BIRMC submission and corporate governance section in Annual Report 2020.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
a) The Banking Act Direction No.11 of 2007 and subsequent amendments thereto on CorporateGovernanceF or Licensed Commercial Banks in Sri Lanka issued by the Central Bank (i) Section 3(1)(i)(iii)	Though the Self-evaluation of CEO and KMPs has to be submitted to the board as per the section 2.21 of code of best practice and a summary has to be submitted to the Board for their review and to discuss areas of weaknesses and recommend changes where necessary, such evaluations for 2020 had not submitted to the board.	The Self-evaluations of the CEO/GM and Page 12 Section 3(6)(iii)(b) Section 3(6)(iii)(c) Section 3(6)(iv)(d) KMPs for the period of 01-01-2021 to 31-12-2021 to be submitted to the March. Board meeting.	Need to submit every year for better governance.
(ii)Section 3(6)(iii)(b)	Though the goals and targets for the directors, CEO and the key management personnel should be documented to be considered by the Human Resources and Remuneration committee, for directors and key management personnel had not considered.	The performance of the CEO/GM has been submitted to the BHRRC VIDE BHRRC No. 162/2021 and 163/2021	Directors and the key management personnel also need to be considered by the Human Resources and Remuneration committee for better governance.

(iii) Section 3(6)(iii)(c)		Two way performance appraisals against predetermined goals are currently carried out; including for the Chief Executive Officer/ General Manager. For the period ended December 31, 2021 - these will be submitted to the upcoming Board Human Resource Remuneration Committee.	
(iv) Section 3(6)(iv)(d)	Though a new performance evaluation template for the corporate and executive management of the bank has been developed (BHRC No. 104/2019), Committee has to initiate actions to consider performance evaluations of CEO and key management personnel against the set goals and targets going forward for better governance.	The Declaration of the Directors and CEO's to be submitted to the March Board meeting prior to submit to the CBSL.	Need to consider against the set targets and goals going forward for better governance.
b) According to the Public Enterprise Circular No PED 03/2016 dated 29 April 2016 Paragraph (2)	Declarations of Directors and CEO have not been submitted through the Nomination Committee. 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	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.	Has to initiate actions to submit declarations of Directors through the Nomination Committee going forward for better governance. Need to adhere with relevant regulations.

on that, the Bank has paid Rs.26 Mn as PAYE tax on behalf of employees for the year ended 31 December 2020, without deducting from employee's earnings.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit before tax of Rs.21, 226.7 Million and the corresponding profit in the preceding year amounted to Rs.19, 666.2 Million. Therefore a improvement amounting to Rs.1, 560.5 Million of the financial result was observed. The main reason for the improvement is reduction of tax expense due to abolished of Nation Building Tax and Nation Building Tax on Financial Services and reduction of Value Added Tax rate.

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	(6,996,692)	3.7	Interest income declined by 3.7% to LKR 179 Bn. in 2020, due to Interest Rate Reduction in the Industry.
Interest Expense	(6,723,955)	5.4	Interest expenses declined by 5.4% to LKR 118 Bn. in 2020, due to Interest Rate Reduction on deposits.
Other Expenses	(1,888,714)	11	Other Expenses decreased by 11% to LKR 15 Bn. In 2020, due to cost controlling during COVID 19 period. Approximately 1/4 th of the decrease accountable to the Marketing and promotional cost.
Impairment Charge	3,079,148	36.3	<ol style="list-style-type: none"> 1. PD of a major customer was changed from computed PD to a PD based on sovereign rating. 2. Few other customers were moved to stage II from stage I as a measure of prudence. 3. Increase in Economic factor Adjustment.
Value Added Tax (VAT), Nation	(5,058,309)	56.8	Decreased by 56.8% to LKR 3.8 Bn. in 2020 from LKR 8.9 Bn. in 2019, due to abolition of NBT &

Building Tax (NBT)
and Debt Repayment
Levy (DRL) on
financial services

DRL

Personnel Expenses 228,293 1.2 Personnel Expenses increased by 1.2% to LKR 19.7 billion in 2020 from LKR 19.5 billion in 2019, primarily due to the increase in pension costs.

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	
		2020	2019
Performance Ratios			
Return on Equity (ROE)	10.9	14.4	13.9
Return on Assets (ROA)	1.0	1.0	1.1
Interest Margin	3.1	3.0	3.2
Assets Quality Ratio			
Gross Nonperforming Advances (NPL)	4.7	3.2	3.3
Capital Adequacy Ratios			
Tier 1 Capital (Minimum 10%)	13.1	9.5	10.7
Total Capital (Minimum 14%)	16.7	15.5	14.7
Statutory Ratio			
Liquid Assets Ratio (Minimum Requirement 20%)	33.8	25.61	21.7
Liquidity Coverage Ratio (Minimum Requirement 100%)		Rupee - 166.82 All currency - 111.55	Rupee - 160.80 All currency - 132.10

3. Operational Review

3.1 Uneconomic Transactions

Audit Issue

Even though the bank had paid an advance amounting to Rs. 486,202 and Rs. 795,121 to Silver Lake Structured Services SDN.BHD for two projects during the year under review, those projects were abandoned.

Management Comment

Noted. The matter is being looked with a target to resolve before September 30, 2022.

Recommendation

Transactions should be economical and viable.

3.2 Identified Losses

Audit Issue

Management Comment

Recommendation

Loss Event	No. of events	2020	Percentage of Total Value	Number	2019	Percentage of Total Value
		Value Rs. Mn			Value Rs. Mn	
Internal Frauds	1	0.43	0.06	1	4.9	5.80
External Frauds	181	735.5	95.5	311	52.63	62.31
Client, product and business practices	1	23.01	2.99	2	0.67	0.79
Damage to physical assets	4	0.51	0.07	20	2.05	2.43
Business disruptions and system failures	7	0.23	0.03	12	1.15	1.36
Execution, delivery and process management	96	10.5	1.36	121	23.06	27.3
Total	290	770.18	100	467	84.46	100

The swift remedial measures has been undertaken. At present, pursuant to Visa/MasterCard chargeback process, customer accounts, Insurance and Visa/MasterCard support deal, LKR 713 million has been recovered with net loss close to LKR 5.0 million.

Need to strengthen the fraud monitoring system and strictly adhere to internal control systems as preventive measures.

- Although the number of cases of loss events of the bank was reduced, value of Loss events were increased by 812 percent comparing to the previous year due to two major frauds classified under the “External Frauds” and “Client, Product & business practices” amounting to Rs. Rs.718.395 million and Rs.23.007 million respectively.
- Aforesaid external fraud involved with the considerable number of overseas debit card transactions (VISA & Master) originated from particular merchant category codes(MCCs) through Automated Fuel Dispenser (AFDs) at Japan, have not been debited to the relevant customers’ accounts and able to perform transactions in excess of available balances of the accounts .Bank was unable to prevent and detect these fraudulent transactions as because of the certain deficiencies in the card system and not following certain internal controls.
- Aforesaid loss event categorized under the category of “Client, Product & Business Practices” was related to the collection of cheques in five instances to the particular current account of a Rice Mill aggregated to Rs.23.007 million without presenting physically. According to the Bills of Exchange Act, accept to collect/pay against image of a cheque or something alike in place of cheque suppose to be a breach of the Act. Further image of the Bank was damaged due to breach of trust reposed on the bank. Accordingly it evident by Lanka Sathosa Ltd had complained about this incident and expressed their serious doubt about the bank practice. Hence this states the negligence and omission of lawful act committed on acts of misconduct.

3.3 Operational Inefficiencies

Audit Issue

a) Bank had granted Rs.654,747 million loans during the year 2020 and out of that Rs.5, 475 million had been transferred to non performing category as at 30 September 2021. Out of that Rs.202.9 million had not been recovered even a single installment, Rs. 174.1 million had not been recovered any capital installment and Rs. 28.7 million had not been recovered any interest installment respectively as at 30 September 2021.

Management Comment

At December 31, 2021 - OBU SOE exposure reduced to 64% as a result of the following; a. Settlement of USD 471 million (Rs. 94,553 Mn) FCY DST loans during 2021. This has reduced FCY DST lending to USD 200 million from over USD 650 million at December 31, 2020 b. Pursuant to

Recommendation

Need continuous follow ups on non performing loans.

b) Total outstanding balance of loans & advances belongs to State Owned Enterprises (SOEs) were Rs. 845 billion which represent 49.02 percent out of the total loan and advance of the bank. This indicates Rs. 244 billion or 40.50 percent increment during the year under review comparing with the previous year. Although the bank's total asset base increased by 357 billion or 19.04 percent to 2,230 billion as at 31 December 2020 compared to the previous year, 37.88 percent represent by the loan and advance to SOE's.

c) The total outstanding balance of loans and advances of Off-shore Banking Unit as at 31 December 2020 was Rs. 374,821 million and out of that Rs. 329,445 million or 87.89 percent belongs to the SOEs which represents increment by Rs. 76,501 million or 30.24 percent during the year under review comparing with the previous year. The total of Rs. 9,086 million or 2.42 percent shown as non-performing loan (NPL) balance. Total non-performing balance had been increased by Rs. 524 million or 6.12 percent during the year under review comparing with the previous year. Top 10 non-performing loans and advances of Off-shore Banking Unit as at 31 December 2020 had been recorded as Rs. 9,034 million with capital of Rs. 4,652 million and interest of Rs. 4,382 million which represents 99 percent of aforesaid total NPL.

d) Total Non -performing loans over 5 million of the bank as at 31 December 2020 was Rs. 67,381 million including the capital of Rs. 33,000 million and interest of Rs. 34,381 million which had occupied 77 percent of Total Non-performing Loans

ALCO decision of October 7, 2021 - transfer of CPC capital outstanding of USD 716 million from OBU to DBU. To save any doubt, this was for better liquidity management purposes and was carried out post the Board of Directors approval and CBSL clearance c. Total NP O/S as at 31.12.2021 was USD 39.68 million (or Rs. 7,967 Mn). Efforts are being made to collaboratively with the Recoveries Department to recover/ reduce the NP position(s) in a time and manner soonest reasonably possible.

Out of the total balance of the over LKR 5.0 million loans as herein referred to, litigation proceedings have been initiated to recover the capital balance amounting to LKR 13,686 million, Parate proceedings has been initiated to recover the capital balance amounting to LKR 2,660 million and settlements are being

negotiated to recover capital balances amounting to LKR 14,636 million. A capital balance of LKR 2,202 million has already settled or classified as performing at 31.01.2022 due to satisfactory performance post re-securement.

e) Total Non -performing OD's over 5 million of the bank as at 31 December 2020 was Rs.7,667 million including the capital of Rs.4,053 million and interest of Rs. 3,614 million which had occupied 53 percent of Total Non-performing ODs.

Out of the total balances of over LKR 5.0 million in OD's as herein referred to, litigation proceedings were initiated to recover the OD's with capital balances of LKR 1,160.0 million, settlements are currently being negotiated for capital balances of LKR 2,483.0 million and Parate execution are being performed to recover a sum of LKR 175.0 million. Overdrafts with the value of LKR 235 million has already been classified as performing or settled as at 31.01.2022.

f) Total outstanding of top 10 non-performing loans as at 31 December 2020 was Rs.47,366 million including the capital of Rs.21,902 million and interest of Rs.25,463 million which represents 40.75% of total gross non-performing loans and advances. Out of that Rs. 26,652 million or 56.3 percent from above advances do not have any securities and Rs.2,235 million or 4.7 percent from above advances do not have adequate securities.

Please refer Annexure 3.3 (VI) for details relating to current status of recovery actions of the top largest 10 NP borrowers.

No	Name of the customer	Capital Balance	Interest Balance	Total Balance
01	CML GROUP	3,596	1,084	4,680
02	THE GRAND MOUNTAIN	3,136.9	427	3,563.9

	GROUP			
03	W M MENDIS AND COMPANY LTD	3,063	812.7	3,875.7
04	YASHODA GROUP	3,030.4	20,950.2	23,980.6
05	MIHIN LANKA(PVT) LTD	2,500.5	1.5	2,502
06	HURAVEE INTERNATIONAL PVT LTD	1,785	393.8	2,179
07	DAYA APPERAL GROUP	1,159.8	783.4	1,943.2
08	NAWALOKA GROUP	1,577.4	121.8	1,699.3
09	GOOD FELLOWS (PVT) LTD	1032.5	872.7	1905.3
10	CITY CONSTRUCTION CONTRACTORS (PVT) LTD	1,020.9	15.5	1,036.5

g) Total outstanding of top 10 non-performing loans restructured/rescheduled and transferred to non performing during 2020 as at 31 December 2020 was Rs.1,084 million including the capital of Rs.1,067.6 million and interest of Rs.16.4 million which represents 1.99 percent of total gross non performing loans and advances. Out of that Rs. 350 million or 32.30 percent from the above advances do not have any security.

No	Name of the customer	Capital Balance	Interest Balance	Total Balance
01	CITY CONSTRUCTION CONTRACTORS (PVT) LTD	786.7	15.1	801.8
02	CEYLINCO SUSSEX EDUCATIONAL SERVICES LTD	61.9	0.2	62.2
03	MICRO ENTERPRISES	43.9	-	43.9

h) EAST WEST MARKETING (PRIVATE) LIMITED: Directors Personal Guarantees have been extended and we considered PG as security and Mr. Jayantha Darmadasa and U.H. Darmadasa are high Net worth personals and the security can be realized when litigation is commenced. Therefore this facility also can be considered as secured.

NEW PAL PACKAGING (PVT) LTD: All facilities are secured by mortgage

04	ARIYAPALA	31.9	-	31.9
05	KUMARAGE	27.7	-	27.7
06	EAST WEST MARKETING (PRIVATE) LIMITED	26.2	0.1	26.3
07	D M JEEWAN PVT LTD	25.8	0.1	25.9
08	NEW PAL PACKAGING (PVT) LTD	24.9	0.8	25.7
09	DUMINDA BUILDERS PVT LTD	21	0.01	21.03
10	ZULFIKAR	17.5	-	17.5

over property and mortgaged bonds are already obtained for all facilities.

- i) Accumulated amount of Rs 645.51 Million of non-performing loans and advances had been written off/waived off since 2016 to 2020 and Rs.195.7 million were written off/waived off during the year 2020.

Although written off, PB Management/ Recoveries Department has subsequently had success in recovering a portion of the said sum(s) written off.

3.4 Human Resources Management

Audit Issue

According to the analysis of published financial statements, personnel expenses as a percentage of net operating income of the bank was 32.79 per cent for the year 2020 representing highest value comparison with other commercial banks of Bank of Ceylon, Commercial Bank, Sampath Bank and Hatton National Bank which reported ranging from 27.24 per cent to 29.72 percent, which resulted to reduction in the contribution to the profit per employee.

Management Comment

Not commented.

Recommendation

Need necessary actions to effectively use the bank funds while increasing the efficiency of employees.