

**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 2022, 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 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, Section 13(1) of the Finance Act, No. 38 of 1971 and Section 42(2) of the Monetary Law Act (Chapter 422). 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 2022, 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 Monetary Board and Those Charged with Governance for the Financial Statements**

Monetary Board is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as Monetary 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, Monetary 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 Monetary Board.
- Conclude on the appropriateness of Monetary 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. 374.3 billion as compared with the net profit of Rs. 158.2 billion in the preceding year, thus indicating a decrease of Rs. 532.5 billion in the financial results. The significant decrease in foreign currency investment income as compared with the previous year, was the main reason attributed for this deterioration.

### 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.

	2022	2021	Variance	
	Rs. Bn.	Rs. Bn.	Rs. Bn.	percentage
			[Favorable/(Adverse)]	
<b>Income from Foreign Currency Financial Assets</b>	<b>(135.7)</b>	<b>66.6</b>	<b>-202.3</b>	<b>(303.8)</b>
Interest Income	1.5	4.4	-2.9	(65.9)
Gain/(Loss) from Unrealized Price Revaluations	(127.3)	41.9	-169.2	(403.8)
Gain/(Loss) from Realized Price Changes	(9.9)	20.3	-30.2	(148.8)
<b>Expenses on Foreign Currency Financial Liabilities</b>	<b>33.0</b>	<b>1.3</b>	<b>-31.7</b>	<b>(2,438.46)</b>
Interest Expense	32.3	3.6	-28.7	(797.2)
Reversal/ (Charge) of Expected Credit Losses on Foreign Currency Financial Assets	(0.7)	2.3	-3.0	(130.4)
<b>Net Foreign Exchange Revaluation Gain/ (Loss)</b>	<b>(610.1)</b>	<b>34.0</b>	<b>-644.1</b>	<b>(1,894.4)</b>
<b>Total Net Income from Local Currency Financial Assets</b>	<b>437.7</b>	<b>58.9</b>	<b>378.8</b>	<b>643.1</b>
<b>Other Income</b>	<b>2.4</b>	<b>16.3</b>	<b>(13.9)</b>	<b>(85.3)</b>
<b>Other Expense</b>	<b>10.3</b>	<b>-</b>	<b>(10.3)</b>	<b>(100)</b>
<b>Operating Expenses</b>	<b>25.3</b>	<b>16.3</b>	<b>-9.0</b>	<b>(55.2)</b>
<b>Tax</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Profit/(Loss) for the year</b>	<b>(374.3)</b>	<b>158.2</b>	<b>-532.5</b>	<b>(336.6)</b>

- (a) As per Section 41 of the Monetary Law Act, foreign exchange revaluation gain or loss shall not be included in the computation of the annual profits and losses of the Bank. Therefore, the profit for the year under review was Rs. 235.8 billion (excluding net foreign exchange revaluation loss of Rs. 610.1 billion) as compared with the gain of Rs. 124.1 billion (excluding net foreign exchange revaluation gain of Rs. 34 billion) in the preceding year, thus indicating an improvement of Rs. 111.7 billion in the profit.

(b) The distributable profit for the year under review as determined in terms of Sections 38 and 41 of the Monetary Law Act and profit distribution policy of the Bank approved by the Monetary Board (effective from 2018) was Rs. 235.03 billion as compared with the distributable profit of Rs. 74.6 billion in the preceding year. As per Section 39 (b) of the Monetary Law act, net profit remaining shall be carried to surplus until such time as the equity to domestic asset ratio reaches 15 per cent. Accordingly, the entire distributable profit of Rs. 235.03 billion for the year 2022 was decided to be transferred to surplus. However, a sum of Rs.30 billion or 40 per cent had been distributed to the Consolidated Fund out of the distributable profit for the year 2021.

### 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 rose to Rs. 2,481 billion (Book value) at the end of year 2022 from Rs. 1,351 billion (Book value) stood at the end of year 2021. It was Rs. 25 billion (Book value) and Rs. 638 billion (Book value) at the end of years 2019 and 2020 respectively. Accordingly, The Bank’s holding of treasury bills raised to around 60 per cent of outstanding treasury bills issued by the government at the end of year 2022 from 59.5 per cent at the end of year 2021.
- b) The total value of local currency financial assets had increased substantially to Rs. 3,492.9 billion or 57.2 per cent at the end of year 2022 from Rs. 2,221.7 billion at end of year 2021. This was mainly due to the increase of Treasury bill holdings by Rs. 1,129.5 billion. According to the Section 39 (b) of the Monetary Law Act, the statutory equity to domestic asset ratio should be 15 per cent. However, this ratio was 2.34 per cent at the end of year 2022.
- c) According to the annual financial statements of the Bank, the value of foreign assets of the Bank had increased by Rs.192.6 billion or 24 per cent to Rs. 991.4 billion at the end of year 2022 from Rs. 798.8 billion at the end of year 2021. 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, negative net foreign asset balance had decreased to Rs. 963.0 billion as at the end of June 2023.

## 3. Observations on operational matters

### 3.1 The Licensing, Regulation and Supervision of Companies carrying on Microfinance Business

Audit Observation	Management Comment	Recommendation
The Licensing, Regulation and Supervision of Companies carrying on Microfinance Business are carried out by the Monetary Board of the Bank under the Microfinance Act No. 06 of 2016 (Act) with effect from 15 July 2016. Companies which are accepting deposits and providing financial services mainly to low-income persons and micro enterprises (Micro Finance Business) should obtain a license under the Act. Companies which are not accepting deposits but providing financial services to low-income persons and micro enterprises in the country do not require obtaining a	Agreed. It is in accordance with the Law	Need to regulate Companies which are not accepting deposits but providing financial services to low-income persons and micro enterprises.

license under the Act. Therefore, those companies are not regulated and supervised by the Monetary Board of the Bank under the Act even till the end of November 2023.

### 3.2 Pension payment to the Governor of the Bank

Audit Observation	Management Comment	Recommendation
<p>The Corporate Management Committee of the Bank at its meeting held on 09.11.2020 had recommended incorporating rules for pension benefits for a person appointed as the Governor of the Bank in to the rules of the new pension scheme and it had been approved by the Monetary Board at its meeting held on 23.12.2020. Accordingly, the person appointed as the Governor of the Bank had entitled to pension benefits. However, it was observed that minimum period of serving as the Governor of the Bank to entitle to the pension benefits had not been stipulated in the pension rules applicable for the Governor.</p>	<p>Agreed. It will be reviewed by the Governing Board in due course.</p>	<p>Need to expedite the review process.</p>

### 3.3. Maintenance of Government Securities portfolio

Audit Observation	Management Comment	Recommendation
<p>It was observed that the Bank manually maintains the government security portfolio using excel spreadsheets. Actions had not been taken to automate the maintenance of the government security portfolio, to minimize potential errors that may occur due to excessive human intervention and because of the significance of the portfolio amounting to approximately Rs. 2.5 trillion at the end of December 2022.</p>	<p>The Bank believes that the risk is minimized even though the current process is manually maintained, as there are other control measures to check the accuracy of the portfolio such as verification with entries to General Ledger is matched with the supporting documents sent by the other relevant departments and the preparation and checking is done by separate officers. Further, Finance Department is in the process of automating the maintenance of the Bank's Government security portfolio and the finalization of the same is scheduled to be in mid- 2024.</p>	<p>Need to expedite the automation process.</p>

### 3.4. Reserve Bank of India (RBI) Swaps

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
The Bank had entered into a bilateral currency Swap facility with RBI in 2020. The second drawal of USD 400 under this facility was effected in January 2022 and rolled over in April 2022. It became payable from July 2022. As per the confirmation received from RBI, it was observed that RBI had charged USD 72,728 as penal interest from the Bank.	Agreed. Subsequently, the accounts have been corrected to reflect the penal interest payment in 2023. Since the amount is not material it is considered as a non-adjusting entry in the financial statements of 2022.	Need to avoid the penal interest payments.

### 3.5 Reimbursement of the Transaction cost of Worker's Remittances

<b>Audit Observation</b>	<b>Management Comment</b>	<b>Recommendation</b>
Bank decided to grant an incentive to Sri Lankans working abroad by reimbursing the transaction cost incurred on account of inward workers' remittances as a fixed payment of Rs. 1,000 per transaction with an objective of encouraging more workers' remittances to the country through formal fund transferring channels. Operating instructions in relation to this matter were issued on 19 January 2022. Total expense for the year 2022 in relation to the above, amounted to LKR 10.3 billion. Further, as per the operating instructions issued by the Bank on 22.12.2020, the Budget 2021 had proposed to pay Rs. 2 per dollar as incentive with an objective of encouraging more worker's remittances to the country through formal fund transferring channels. Further, an additional incentive of Rs. 8 per USD was provided during the period from 01.12.2021 to 8 March 2022. However, total worker remittances received during the years of 2020, 2021 and 2022 were USD 7,103.9 million, USD 5,491.5 million and USD 3,789.5 million respectively.	Agreed	Need to address the main issue of exchange rate policy in making these types of decisions in future.