

National Savings Bank – 2010

1.1 Group Financial Statements

The Bank had owned 100 per cent share capital of the National Savings Bank Fund Management Company Limited. The position of the investment of the Bank as at 31 December 2010 and as at end of the preceding year is given below.

<u>Cost</u>	<u>2010</u> <u>Directors' Valuation</u>	<u>Cost</u>	<u>2009</u> <u>Directors' Valuation</u>
Rs.('000)	Rs.('000)	Rs.('000)	Rs.('000)
150,000	150,000	150,000	150,000

1.2 Directors' Interests in Contracts with the Bank

According to the information made available, Directors of the Bank were not directly or indirectly interested in any contracts with the Bank other than that disclosed in Note 29 to the financial statements.

1.3 Contribution to the Consolidated Fund and General Reserves

According to the financial statements, net profit of the Bank and contribution to the Consolidated Fund and General Reserves for last 05 years are given below.

<u>Year</u>	<u>Net Profit</u>	<u>Contribution to the Consolidated Fund</u>		<u>Contribution to the General Reserves</u>	
	Rs.('000)	Rs.('000)	%	Rs. ('000)	%
2006	1,884,746	1,000,000	53	790,509	42
2007	1,573,074	1,250,000	79	957,086	61
2008	1,059,267	1,000,000	94	6,303	1
2009	3,714,231	1,750,000	47	1,778,520	48
2010	5,401,147	2,664,084	49	2,467,005	46

2. Financial Statements

2.1 Opinion

So far as appears from my examination, I am of opinion that the National Savings Bank had maintained proper accounting records for the year ended 31 December 2010 and the financial statements give a true and fair view of the state of affairs of the National Savings Bank as at 31 December 2010 and its Profit and Cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

I am of opinion that the consolidated financial statements, give a true and fair view of the state of affairs as at 31 December 2010 and the profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards, of the Bank, and its subsidiary dealt with thereby, so far as concerns the shareholders of the Bank.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

(a) **SLAS 18**

Revaluation had not been made in respect of fully depreciated fixed assets valued at Rs. 250,806,551.

(b) **SLAS 36**

Even though receivables from Sri Lanka Navy amounting to Rs. 34,600,000 being contingent asset by its nature, the Bank had recognized it as an asset in the Balance Sheet, without disclosing it in Notes to the financial statements.

2.2.2 Accounting Deficiencies

The following observations are made.

- (a) The Branch at Chatham Street had been vested in the Government on 19 January 2009 due to security reasons. This transaction had been treated in the financial statements as transaction that occurred during the year 2010. Cost of the land amounting to Rs.34,600,000 had been deducted from the total cost of land and buildings and shown as other income receivables in the financial statements for the year under review. Confirmation had not been received from the Government in relation to this receivable amount.

2.2.3 Accounts Receivable and Payable

The following observations are made.

- (a) Sums of Rs. 55,246,473 and Rs.105,950,228 receivable from the Treasury on account of dormant accounts had remained outstanding for over three years and five years respectively.
- (b) Fraudulent withdrawals amounting to Rs.19,836,607 had remained outstanding as at 31 December 2010.
- (c) Sundry creditors (Account code 66103) balances totaling Rs.2,322,881 representing 15 percent of the total creditors had remained outstanding for over two years without being settled. Further sundry creditors amounting to Rs. 4,427,603 had remained outstanding for periods ranging from 1 year to 2 years.
- (d) Sundry creditors amounting to Rs.57,589 relating to Branches had remained outstanding for over three years without being settled.
- (e) A sum of Rs. 219,016 representing 41 per cent of the unclaimed balances had remained outstanding for over two years.

2.2.4 Lack of Evidence for Audit

The following observations are made.

- (a) Balances totaling Rs.1,789,000,334 relating to 9 items could not be satisfactorily vouched or accepted in audit in the absence of documentary evidence such as age analysis, agreements and verification reports as applicable.
- (b) Out of the 119 audit queries issued in the year under review and the two preceding years, the Bank had not furnished replies for 33 audit queries up to 30 June 2011 and that included replies for 9 out of 71 audit queries issued in two preceding years.

2.2.5 Non – compliance with Laws, Rules, Regulations and Management Decisions

Non-compliances with the following laws, rules, regulations and management decisions observed in audit are given below.

Reference to Laws, Rules, Regulations and Management Decisions	Non - compliance
-----	-----
(a) Section 84(3) of the National Savings Bank Act, No. 30 of 1971	Rules relating to Disciplinary Management had not been published in the Gazette.
(b) Inland Revenue Act, No 10 of 2006 amended by Act, No. 10 of 2007	In 103 instances Tax Declaration Statements along with the Application for Opening Accounts had not been obtained from the customers by 11 Branches.

(c) Financial Regulations

- | | |
|--|--|
| <p>(i) Financial Regulation 104</p> | <p>Preliminary and final reports had not been prepared relating to 25 accidents to motor vehicles.</p> |
| <p>(ii) Financial Regulation 756</p> | <p>Boards of Survey Reports for the year under review relating to 56 Branches and 25 Divisions had not been submitted to the Auditor General.</p> |
| <p>(iii) Financial Regulation 1646</p> | <p>Monthly Performance Summaries and Daily Running Charts relating to 46 motor vehicles had not been submitted to audit.</p> |
| <p>(d) Financial Regulation 135 (5) (a) (b) and Section 8-8 of the Public Enterprises Circular No PED/12 dated 02 June 2003</p> | <p>The delegation of authority of financial control of the Bank had not updated at the beginning of each year.</p> |
| <p>(e) Government Procurement Guidelines of the National Procurement Agency Circular No. 8 dated 25 January 2006 as amended by No. 06 dated 5 October 2006</p> | |
| <p>(i) Chapter 2:14:1 and 3:4</p> | <p>External security service for the Bank had been selected at cost of over Rs. 45 million under the Shopping Procedure instead of following Open Competitive Bidding Procedure.</p> |
| <p>(ii) Section 3:2</p> | <p>(a) Even though the Open Competitive Bidding Procedures should be applied for purchase of goods and services,</p> |

valued over Rs. 2 million, only Shopping Procedure had been applied for the following purchases.

(i) Purchase 50 Point Of Sale (POS) Terminals for Post Offices at a cost of Rs.4,335,575.

(ii) Purchase of furniture for 15 Piyasa Branches of the Bank at a cost of Rs.2,472,885.

(iii) Section 5:3:2, 6:2:2

A period of 17 days had been given for bidding for the purchase of 50,000 whistling kettles at a cost of Rs.33,750,000 instead of 21 days as required by the Procurement Guidelines.

(iv) Section 4:2:1

(b) Master Procurement Plan and detailed Procurement Plan had not been prepared for the year 2010.

(f) Circular No. 445/1998 of the General Manager of the National Savings Bank

Even though managerial authorities of the computer activities of a branch should be delegated to one officer, such authorities in respect of 06 Branches had been delegated to several officers.

(g) Circular No 681/2007 of the General Manager of the National Savings Bank

(i) A copy of the National Identity Card and the Birth Certificate of each of the customer had not been

obtained in the opening of 255 accounts by 14 Branches of the Bank.

(ii) Know Your Customer (KYC) forms along with the application for opening of accounts had not been obtained from the customers by 09 Branches in 79 instances.

(h) Circular No 769/2010 of the General Manager of the National Savings Bank

Even though all passwords which were not used for over 10 days should be disabled by the Branch Manager, Managers of 09 Branches had not complied with this instruction.

3. Financial and Operating Review

3.1 Financial Results

(a) According to the financial statements presented, the operations of the Bank during the year under review had resulted in a pre-tax net profit of Rs 9,788 million as compared with the corresponding pre-tax net profit of Rs 6,944 million in the preceding year thus indicating an increase in the financial results by Rs 2,844 million or 41 per cent. Gains from investment securities amounting to Rs 1,583 million had been the major contributory factor for this increase.

The operations of the Subsidiary of the Bank during the year under review had resulted in a pre-tax net profit of Rs 435 million as compared with the corresponding pre-tax net profit of Rs 1,115 million in the preceding year thus indicating decrease in the financial results by Rs 680 million.

(b) The pre - tax net profit for the year under review amounting to Rs. 9,788 million included the profit of the Head Office amounting to Rs. 4,695 million and the profit of 145 Branches (Bank Branches, Postal Branches, Piyasa Units

and Divisions) amounting to Rs. 5,281 million less losses of 47 Bank Branches amounting to Rs. 188 million.

- (c) Cumulative income of the Bank had decreased by Rs.904 million thus indicating a decrease of 1.8 per cent as compared with the corresponding cumulative income of the preceding year.
- (d) The Bank had made a provision of Rs. 250,000,000 for the new IT System. However it was observed that this had been recognized as a payable under Current Liabilities in the financial statements.

3.2 Significant Ratios and Percentages

According to the information made available, certain important ratios of the Bank for the year under review and the preceding year are given below.

	<u>2010</u>	<u>2009</u>
	%	%
(a) <u>Profitability Level</u>		
(i) Net Interest Margin	32.43	28.62
(ii) Return on Equity	26.36	20.91
(b) <u>Capital Adequacy</u>		
Equity/ Total Assets	0.05	0.05
(c) <u>Liquid Assets</u>		
Deposits/ Loans and Advances	4.35	4.58

The following observations are made in this connection.

- (a) Net Interest Margin and Return on Equity had significantly increased during the year under review as compared with the preceding year.
- (b) Deposits against loans and advances had slightly decreased during the year under review as compared with preceding year.

3.3 Branch Performance

According to the information furnished, the performance of the Bank Branches during the year under review as compared with the preceding year is given below.

	<u>2010</u>	<u>2009</u>
(a) Numbers of Branches	186	126
(b) Numbers of Savings Shops		-
(c) Numbers of Postal Branches	19	19
(d) Numbers of Post Offices	4053	4,055
(e) Numbers of Account Holders (millions)	16.7	16.3
(f) Numbers of ATMs	191	148
(g) Number of Piyasa (Units)		19
(h) Number of School Bank Units	373	262

Sixty new Branches had been opened, and 19 Post Offices and Piyasa Units had been converted as Branches during the year under review. Number of accounts holders had increased by 0.4 million and ATM net work had increased from 148 to 191 during the year under review showing a remarkable progress in the operations of the Bank.

3.4. Maturity Pattern

The maturity patterns of the assets and liabilities are as follows.

	Up to 3	3-12	1-3	3-5	Over 5
	Months	Months	Years	Years	Years
	-----	-----	-----	-----	-----
	Rs.mn	Rs.mn	Rs.mn	Rs.mn	Rs.mn
<u>Assets</u>					
Interest bearing	55,830	94,084	134,239	52,419	39,603
Non-interest bearing	9,780	11,485	284	53	5,453
	-----	-----	-----	-----	-----
	<u>65,610</u>	<u>105,569</u>	<u>134,523</u>	<u>52,472</u>	<u>45,056</u>

Liabilities

Interest bearing	196,587	160,474	6,259	3,209	-
Non- interest bearing	5,783	7,523	2,635	246	20,515
	-----	-----	-----	-----	-----
	<u>202,370</u>	<u>167,997</u>	<u>8,894</u>	<u>3,455</u>	<u>20,515</u>
Liquidity Gap	(136,760)	(62,428)	125,629	49,017	24,541

Analysis of the maturity profile of the assets and liabilities of the Bank in a monthly level revealed that the total liabilities were far in excess of the assets and the short term liquidity gap up to 3 months and 3-12 months in the year 2010 were negative values Rs. 136,760 million and Rs. 62,428 million respectively.

3.5 Loan Administration

3.5.1 The position of loans and advances granted up to the end of the year under review as compared with the preceding year is given below.

<u>Facility</u>	<u>Number of Accounts</u>		<u>Amount Granted</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u> Rs.(Millions)	<u>2009</u> Rs.(Millions)
House and Property Loans	8,003	3,536	7,722	3,482
Pawning Loans	990,790	551,459	36,185	15,324
Personal Loans	2,090	4,396	283	357
Project Loans	1	12	1,638	5,185
Vehicle Loans	45	5	55	8
Loans to Government of Sri Lanka	1	2	280	6,570
	-----	-----	-----	-----
Total	<u>1,000,930</u>	<u>559,410</u>	<u>46,163</u>	<u>30,926</u>

Number of Personal Loans Accounts and Project Loans Accounts had decreased significantly by 2,306 or 52 per cent and 11 or 92 per cent respectively as compared with the preceding year.

3.5.2 Project Loan granted for the Construction of a Housing Scheme at a cost of Rs.80 million

The following observations are made on this transaction.

- (a) The above loan amounting to Rs.80 million had been granted in two disbursements for a housing scheme. None of the installments and interest had been paid up to the expiry of the repayment period.
- (b) The Bank had taken over the property since the unavailability of customers to buy the property at the auction.
- (c) The property of 2 acres 3 roods and 31.7 perches in extent was valued at Rs.184 million, and Sri Lanka Navy had paid only a sum of Rs.130 million for the purchase of this land. Though the property had been pledged to another Bank for a facility amounting to Rs.50 million, both Banks had agreed to share the amount realized from auction on the basis of 8:5 ratio.
- (d) Out of 35 houses in the housing scheme which were purchased by Sri Lanka Navy, cases had been filed on 5 houses by third parties. According to the order of the Court on above 5 houses Bank had paid Rs.9.7 million and net amount received by the Bank in this connection amounting to Rs.70.3 million thus resulting in a loss of Rs.42.9 million to the Bank.
- (e) A land valued at Rs.13.3 million had been vested in the Government in June 2009 and the Branch had not received any payment for this transaction.
- (f) The Bank had taken over a portion of the Land for the construction of a Circuit Bungalow on the payment of a sum of Rs.2.1 million to the other Bank as its share of the value, Nevertheless the Bank has not taken any action on the construction of the Circuit Bungalow.

3.5.3 Non- performing Loans

According to the information made available, total non-performing loans, provision for loan losses and interest in suspense are given below.

Loan Category	Total Outstanding Loans	Non- performing Loans	Loan Loss Provision	Interest in Suspense
	Rs. Mn	Rs. Mn	Rs. Mn	Rs. Mn
Housing and Property Loans	33,215	2,046	504	203
Development Finance Loans	6,018	9	90	-
Personal Loans	660	63	33	12
Others	42,446	1	5	2
	82,339	2,119	632	215

3.5.4 Provision for Loan Losses

Details of loan loss provision for the year under review and the preceding year are given below.

Period	Provision for Balance of the Principal Amount Outstanding		Outstanding Loan Balance		Provision	
	2010 %	2009 %	2010 Rs.	2009 Rs.	2010 Rs.	2009 Rs.
6- 12 Months	0.97	0.78	372,017,000	538,656,489	3,614,000	4,181,409
12-18 Months	5.28	9.14	141,438,000	102,005,095	7,471,000	9,319,338
Over 18 months	13.86	25.2	218,179,000	114,539,249	30,239,000	29,085,185

The following observations were made.

- (a) The deposit received for the land auctioned on 04 May 2006 amounting to Rs.1,861,382 had been included in the Sundry Creditors Suspense Account. This amount had remained unsettled up to the date of this report due to a pending court case in relation to this property.
- (b) It was observed that the value of properties taken over by the Branch during the period of 2000 to 2009 relating to 8 housing loans and a project loan amounted to Rs.14,932,216. Further action had not been reported. Further, it was observed that court cases relating to three loan accounts were pending.

3.6 Operating Review

The following observations are made.

3.6.1 Sales Promotion Activities of SMILE Account

The following observations are made.

The main objectives of introducing the new savings account named "SMILE" on 31 October 2010 were the development of savings among the rural public, increase the percentage of domestic savings and introduce the most benefited savings accounts to the depositors. The Bank had targeted to acquire a deposit value of Rs 4 billion through this new savings product in the year 2011.

- (a) According to the Circular No 750/2009 of the General Manager of the Bank Specific guidelines to be followed in introducing new products have been issued while the Product Development Committee (PDC) is responsible for the development of new products of the Bank. However it was observed that the Bank had not followed those guidelines in the introduction of new "SMILE" savings account.

- (b) The Bank had introduced SMILE savings account after introducing "Happy Savings" Accounts on 26 August 2008. No other accounts had been introduced during the last two years.

3.7 Uneconomic Transactions

Eighteen Storeyed Building of National Savings Bank

The Board had approved the construction of a new building for the National Savings Bank with 18 floors in the year 2006 but the construction was temporarily stopped on a decision of the Board of Directors dated 21 September 2007 in view of the building site situated in a high security zone declared by the Government. Therefore, the cost incurred on Project activities amounting to Rs. 35,228,367 was identified as fruitless expenditure.

3.8 Return on Investments

- (a) Cost and return of strategic investments as at 31 December 2010 are given below.

Strategic Investment	Cost of Investment	Return	Return on Investment
-----	-----	-----	-----
	Rs.	Rs.	%
Hatton National Bank	1,106,777,575	31,479,255	2.84
Sri Lanka Telecom	<u>445,642,518</u>	<u>2,960,708</u>	0.66
	<u>1,552,420,093</u>	<u>34,439,963</u>	

Return on investment in the Hatton National Bank and the Sri Lanka Telecom had been shown as 2.84 per cent and 0.66 per cent respectively. Therefore the overall return on investment for the above strategic investments was only 2.22 per cent showing a poor return to the Bank during the year 2010.

- (b) Though the Bank had invested a sum of Rs.5,323,778,529 as at 31 December 2010 in shares of 50 companies, dividends had not been received from 27 companies in which a sum of Rs.1,835,081,390 had been invested. Cost of such investments represented 34.47 per cent, as compared with the total investment cost in quoted companies.
- (c) Dividends had not been received in respect of investment of Rs. 1,462,468,337 made in 17 companies. This represented 27.47 per cent of total investment.
- (d) The Bank had invested a sum of Rs.567, 965,955 in the Indian Oil Company (IOC), which represented 10.67 per cent of the total investments of the Bank. It was observed that no return had been received from this investment for years 2008, 2009 and 2010. Hence return on investment had been recorded as zero, during that period.
- (e) Dividends received in respect of investments for the years 2009 and 2010 amounted to Rs. 48,183,938 and Rs.88,250,954 respectively and represented 2.21 per cent and 1.66 per cent respectively of the total investment

3.9 Human Resources Management

The following observations are made.

- (a) The approval of the Department of Public Enterprises of the General Treasury had not been obtained for the present cadre in terms of Section 9.2 of the Public Enterprises Circular No.PED/12 dated 02 June 2003.
- (b) The following table shows the cadre approved by the Board of Directors and the actual cadre of the Bank as at 31 December 2010.

Designation	Approved Cadre	Actual Cadre	Vacant Positions	Excess positions
-----	-----	-----	-----	-----
Executive Grades	558	498	83	23
Supervisory Grades (Non - Executives)	1,156	860	296	-
Non - Staff Grades	1,525	1,474	445	394
Minor Grades	317	218	100	1
	-----	-----	-----	-----
	<u>3,556</u>	<u>3,050</u>	<u>924</u>	<u>418</u>

- (i) According to the approved cadre, the Executive Level of the Management comprises 558 officers. However the actual cadre stood at 498 officers including the 8 officers appointed on contract basis. Further there were 83 vacancies while 23 excesses existed due to delays in promotions.
- (ii) Top level management of the Executive Grade represented the Special Grade and Grade I level in the approved cadre of the Bank. Existing cadre in Special Grade of the Bank consisted with 21 officers and 3 of them were recruited on contract basis. Further, existing cadre in Grade I level of the Bank consisted with 44 officers and 5 of them were recruited on contract basis. However, 14 vacant posts in respect of the said top level management were prevailing without recruiting up to the end of December 2010.
- (iii) Though the approved Banking Assistant posts were only 920, the Bank had recruited 1,047 Assistants on permanent basis and 259 Assistants on contract basis and as such 386 Banking Assistants in excess of the approved cadre were observed.

- (c) Transport Manager had been transferred to Administration Division from Transport Division due to the poor maintenance of the General Manager's vehicle. Furthermore, designation of the Transport Manager had been changed to Transport Manager (Technical) and his probation period had been extended by one year.
- (i) There was no evidence of Board approval obtained for the change of designation.
 - (ii) In the meanwhile two officers had been assigned with the duties as Managers of the Transport Division during the period December 2009 to December 2010 and the salary and allowances paid to the additional officer during that period amounted to Rs. 1,192,969.

3.10 Commitments and Contingencies

The Bank had been involved in various types of litigation. According to the financial statements presented, 35 cases were pending as at 31 December 2010.

3.11 Corporate Plan and Action Plan

- (a) Certain targets set out in the Corporate Plan for the year under review had not been achieved.
- (b) Certain targets set out in the Action Plan for the year under review had not been achieved.

4. Systems and Controls

Deficiencies observed in systems and controls during the course of audit were brought to the notice of the Chairman of the Bank from time to time. Special attention is needed in respect of the following areas of control.

- Accounting
- Budget
- Loan Administration
- Inventory Control
- Documentation
- Debtors and Creditors
- Compliance with Laws, Rules and Regulations
- Fixed Assets
- Accounts Opening and Closing
- Computer Activities