

Central Bank of Sri Lanka (CBSL) - 2014

The audit of financial statements of the Central Bank of Sri Lanka (CBSL) for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section 42 (2) of the Monetary Law Act, (Chapter 422). In carrying out this audit, I was assisted by a firm of Chartered Accountants in Public Practice to examine the compliance with International Financial Reporting Standards.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on auditing. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risk of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the CBSL's preparation and fair presentation of the financial statements 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 CBSL's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the

Central Bank of Sri Lanka (CBSL) as at 31 December 2014, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiency

Rent income relating to New York building for the year under review had been understated by Rs. 3,479,296 in the financial statements.

2.3 Non-Compliance with Laws, Rules, Regulations and Management Decisions

The following instance of non-compliance with Laws, Rules and Regulations were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions

Non-compliance

(a) Section 39 of Monetary Law Act, (MLA)

According to the provisions in this Section, the profits earned by the CBSL after the appropriations and making settlement of dues from the Government of Sri Lanka should be transferred to the General Treasury within 60 days after the closure of the financial year. Accordingly, a sum of Rs. 8.5 billion had been remitted to the General Treasury in 2 instances in 2014 as advance payments from the profit of first two quarters of the year under review even though, there was a loss of Rs. 32.31 billion. Further, the distributable profit had been calculated by the CBSL after taking into account the net foreign exchange revaluation loss of Rs.32.27 billion and “marked- to- market” gain/loss on foreign assets of Rs.7.97 billion. In addition to that the balance of the retained earnings as at the end of the year under review remained a negative value of Rs. 5.7 billion.

In this connection the Governor of the CBSL had informed me that, “ In September 2009, he sought the concurrence of the Attorney General to transfer a part of net profit of the CBSL to the Government within the financial year after making adjustments as set out under Section 39 of the MLA.

(b) Public Finance Circular No. PF/PE 6 of 31
January 2000

The CBSL had paid Pay As You Earn tax and tax on tax aggregating Rs. 179.2 million and Rs. 178.1 million for the year under review and for the preceding year respectively from its own funds instead of being recovered from the employees.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the CBSL for the year under review had resulted in a pre-tax net loss of Rs.31,532 million as compared with the corresponding pre-tax net loss of Rs. 22,248 million in the preceding year, thus indicating a further deterioration of Rs. 9,284 million in the financial results. The increase of net foreign exchange revaluation loss, and net expenses from local currency financial assets by Rs.5,508 million and Rs.24,601 million respectively as against the increase of net income from foreign currency financial assets by Rs. 22,879 million in compared with the preceding year had been the main reasons attributed for this deterioration.

3.2 Analytical Financial review

The total net operating loss of the CBSL for the year under review was Rs. 20.2 billion including the net foreign exchange revaluation loss of Rs. 32.3 billion as compared with the total net operating loss of Rs. 12.8 billion, (including net foreign exchange revaluation loss of Rs. 26.8 billion) in the preceding year, thus indicating an increase of 58 per cent in the total net operating loss. In the meantime the operating expenses including depreciation and amortization expenses during the year under review was Rs. 11.3 billion as compared with that of Rs. 9.4 billion in the previous year, thus indicating an increase of 20 per cent in the operating expenses. The changes of the revenue and expenditure of the CBSL during the year under review, as compared with the preceding year are shown below.

| | 2014 | 2013 | Change | |
|---|-------------|-------------|---------------|------------|
| | ----- | ----- | ----- | ----- |
| | - | - | | |
| | Rs. Bn. | Rs. Bn. | Rs. Bn. | percentage |
| Income from foreign currency financial assets | 26.9 | 4.0 | 22.9 | 572.5 |
| Expenses on foreign currency financial liabilities | 3.1 | 4.4 | (1.3) | (29) |
| Foreign exchange revaluation gain/ (loss) | (32.3) | (26.7) | (5.6) | 21 |
| Income (Expense) from local currency financial assets | (13.1) | 11.5 | (24.6) | (213.9) |
| Operating expenses | 11.3 | 9.4 | 1.9 | 20 |
| Net loss for the year | (31.5) | (22.2) | (9.3) | (41.9) |

3.3 Local Currency Management

The following observations are made.

- (a) The CBSL had taken a decision not to recycle the coins until the international metal prices increase to a higher level. Total coins of 3.25 million pieces and 2.39 million pieces in denomination with the face value of Rs. 5 and Rs. 2 respectively had remained

unsold for several years up to 31 December 2014.

- (b) It was observed that the movement of stock of several commemorative coins were very slow, thus indicating that the lower public demand had been prevailed thereon. The stock position of such commemorative coins remained in the vaults as at 31 December 2014 are given below.

| Description | Year of Issue | Face Value Rs. | Number of Coins Minted | Number of Coins remained in the Vaults as at 31 December 2014 |
|---|----------------------|---------------------------|-------------------------------|--|
| 2500 Buddha Jayanthi | 1957 | 5 | 500,000 | 20,263 |
| 3 rd Anniversary of Induction of President R. Premadasa (Silver) | 1992 | 1 | 2,000 | 204 |
| 3 rd Anniversary of Induction of President R. Premadasa(Gold) | 1992 | 1 | 100 | 53 |
| 2300 Anubudu Mihindu Jayanthi | 1993 | 500 | 30,000 | 5,696 |
| 50 th Anniversary of UNO | 1995 | 5 | 5,000 | 3,948 |
| 50 th Anniversary of Independence of Sri Lanka | 1998 | 1,000 | 25,000 | 6,542 |
| Cricket World Cup- 1996 | 1999 | 1,000 | 25,000 | 10,031 |
| 50 th Anniversary of CBSL | 2000 | 1,000 | 10,000 | 1,942 |
| 50 th Anniversary of Sri Lanka Navy | 2000 | 1 | 2,000 | 107 |
| 2550 Buddha Jayanthi | 2006 | 2,000 | 10,000 | 8,193 |
| 2550 Buddha Jayanthi | 2006 | 1,500 | 20,000 | 18,515 |
| Cricket World Cup | 2007 | 1,000 | 10,000 | 7,839 |
| 50 th Anniversary of Employees Provident Fund | 2008 | 1,000 | 100 | 20 |

| | | | | |
|--|------|-------|--------|-------|
| 60 th Anniversary of Sri Lanka Army (Silver) | 2009 | 1,000 | 10,000 | 835 |
| 60 th Anniversary of Central Bank of Sri Lanka | 2010 | 5,000 | 5,000 | 3,221 |

3.4 Transactions in Contentious Nature

The following observations are made.

- (a) The CBSL had purchased a property in Brazil by spending a sum of Rs. 122.81 million during the year under review for the purpose of its future operations. The Cabinet approval before purchase of this property had not been obtained by the CBSL and the future plan for utilization of the property had not been decided up to the end of the year under review as well. However, this property had been rented out to the Ministry of Foreign Affairs for a period of two (02) years from 01 February 2015 and the Embassy of Sri Lanka in Brazil had functioned in this premises since that date.
- (b) The CBSL had acquired a building in New York by spending a sum of US\$ 6,207,116 (Rs. 607,121,953) on 24 August 2011 and it had been rented out to the Ministry of Foreign Affairs for three years period from 01 June 2012 at a monthly rental of US\$ 68,000 without being utilized for the intended purposes. However, according to Section 117 of Monetary Law Act, “the CBSL should not engaged in trade or otherwise have a direct interest in any commercial, industrial or other undertaking except such interest as it may in any way acquire in the course of the satisfaction of any of its claims”.
- (c) The CBSL had entered into an agreement with a foreign Company in 2013 for a period of one year and subsequently it had been renewed on 16 March 2014 for another one year period in order to achieve the following objectives,
- To provide a comprehensive information platform where decision-makers in the USA receive clear and accurate information about Sri Lanka’s current achievements and future plans;
 - To adhere the political environment in the United States of America (USA) that is more conducive to enhancing Sri Lanka’s long term political and economic aspiration; and
 - To bring a higher volume of private sector investment to Sri Lanka from the USA.

A sum of Rs. 88.4 million and Rs. 50.2 million had been paid to the above foreign company as service fee in 2013 and 2014 respectively. In addition to that an advance payment of Rs. 12.2 million (US\$ 93,200) had been made to the above company in 2013 for production of two films and telecasting them through electronic media. Further, a sum of Rs. 38.0 million (US\$ 290,488) had been paid in 2014 as a balance payment of the above media project.

In June 2014, the above agreement had been terminated and the CBSL had entered into a

new agreement in August 2014 with another foreign company for an annual service fee of Rs. 99 million to carry out the public relations consulting and lobbying services and out of that a sum of Rs . 49.0 million had been paid to the above company up to 31 December 2014. However, a formal procedure was not seen in selecting the aforesaid company. Further, it was observed in audit that the promotion, projection and protection internationally of Sri Lanka's national interests in accordance with the foreign policy of the Government of Sri Lanka is a responsibility of the Ministry of External Affairs. Therefore, involving in such activities by the CBSL is contradicted to the objectives of the CBSL.

(c) On the request of the Secretary to then President, the CBSL had paid a sum of Rs.1,396,222,710 during the year under review on behalf of the Government of Sri Lanka to three Foreign Service providers for obtaining consultancy services on reimbursable basis from General Treasury. However, no any supporting documents were made available on selection of service providers, work done and the requirement of the services. Later on the Secretary to then President by his letter dated 05 February 2014 informed the Governor to treat this amount as an expenditure of the CBSL. Accordingly, the said amount had been treated as expenditure in the financial statements for the year under review without being claimed it from the General Treasury. Further, this amount represented 68 per cent of the total consultancy advisory professional service expenses amounting to Rs. 2,050,619,000 incurred during the year under review.

(e) The CBSL had entered into an agreement with a foreign company to establish an International Financial Centre in Sri Lanka. According to the agreement, the first installment of US\$ 250,000 had been paid in October 2014. Thereafter, the CBSL had decided to discontinue obtaining services from this company making this as a fruitless expenditure.

In this regard the Assistant Governor of the CBSL had informed me that, "On 23 January 2015, the Monetary Board was informed that since the policy direction for the financial sector under the new Government is expected to be different from the previous direction, obtaining advisory services from the above company by the Central Bank to establish an International Financial Centre in Sri Lanka may no longer be appropriate. The Monetary Board, having considered the information provided, decided at its meeting on 26 January 2015, to discontinue obtaining the services from the above company and was informed of this decision in writing on 23 January 2015".

4. Systems and Controls

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

- a) Currency Management
- b) Control over Land and Building