

Sri Lanka Savings Bank Limited – 2017

The audit of financial statements of the Sri Lanka Savings Bank Limited (“the Bank”) for the year ended 31 December 2017, comprising the statement of financial position as at 31 December 2017 and the statement of comprehensive income, statement of changes in equity and statement of cash flows 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.

This report is issued in terms of Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board’s Responsibility for the Financial Statements

Board of Directors (“Board”) is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal controls as the Board determine 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 Sri Lanka Auditing Standards. 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 misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank’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 Bank’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

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 Bank as at 31 December 2017, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.1.1 Report on Other Legal and Regulatory Requirements

As required by Section 163 (2) of the Companies Act No. 07 of 2007, I state the following:

- a) The basis of opinion, scope and limitations of the audit are as stated above.
- b) In my opinion,
 - I have obtained all the information and explanations that were required for the audit and as far as appears from my examination, proper accounting records have been kept by the Bank and,
 - The financial statements of the Bank, comply with the requirements of Section 151 of the Companies Act No. 07 of 2007.

2.2 Non - compliance with Laws, Rules, Regulations and Management Decisions

Instances of non-compliance observed with the following Laws, Rules, Regulations and Management Decisions are given below.

Reference to Laws, Rules, Regulations and Management Decisions etc.	Non-compliance
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(a) Corporate Governance Direction for License Specialized Bank No. 12/2007 of 26 December 2007.	As per Section 2 (3) of the Direction, the Chairman of the Bank had not obtained the fit and property certification from the Central Bank of Sri Lanka (CBSL) since the appointment to the post.
(b) Resolution passed at the Extraordinary General Meeting (EGM) held on 04 December 2015.	Although the proposal has been passed to transfer all the subscriber shares of the shareholder of the Bank back to General treasury. However, two subscriber shares had not been transferred even up to the end of the year under review.

3. Financial Review

3.1 Financial results

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.707.85 million as compared with the corresponding pre-tax net profit of Rs. 690.88 million in the preceding year thus, indicating an improvement of Rs. 16.97 million in financial results for the year under review. Increase of interest income during the year under review was the main reason attributed for this improvement.

3.2 Value Addition

Although the profit for the year under review was Rs. 603 million, the value addition of the Bank had increased from Rs. 826 million in the year 2016 to Rs. 849 million in the year 2017 after taking into account the personal emoluments, depreciation and tax expenditure aggregating Rs.246 million for the year under review.

3.3 Analytical Financial Review

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

	Sector Ratio	Bank	
	----- 2017	----- 2017	----- 2016
Profitability Ratio			
(i) Return on Average Equity (ROE) (Percentage)	19.2	11.89	13.16
(ii) Return on Average Assets (ROA) (Percentage)	1.5	6.28	6.40
(iii) Net Interest Margin (Percentage)	3.2	10.38	9.40

Capital Adequacy

Capital Adequacy- Tier I (Minimum 5 per cent)	12.8	94*	82*
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Assets Quality

(i) Gross Non- Performing Advance {Including Premuka Savings & Development Bank (PSDB)}	4.3	33	37.06
(ii) Gross Non- Performing Advance (excluding PSDB)	4.3	8.49	9.37

Liquidity Ratios

Liquidity Asset Ratio (Percentage)	61.6	362*	126*
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*Capital Adequacy (Tier I) and Liquidity Ratios were computed by using information submitted by the Bank to the Central Bank of Sri Lanka.

The following observations are made.

- (i) The Bank had maintained a higher liquidity ratio of 362 per cent in the year 2017 and 126 per cent in the year 2016 as compared with sector ratios.
- (ii) The gross non performing advance ratio excluding Pramuka Savings and Development Bank (PSDB) as at the end of the year 2017 was 8.49 per cent which

was higher than sector ratio of 4.3 per cent and this was mainly due to loans given for Rehabilitation of Persons, Properties and Industries Authority (RAPPIA) and Individual & Corporate Sector respectively. However, the gross non - performing advance ratio including PSDB as at the end of the year 2017 was 33 per cent.

- (iii) The Bank had maintained a higher capital adequacy ratio as compared with the sector ratios in the year 2016 and 2017.

3.4 Legal Actions initiated by the Bank

According to the information made available, it was revealed that there were 103 unsettled court cases filed by the Bank against outsiders as at the end of the year under review by claiming Rs. 2,121,319,656.

4. Operating Review

4.1 Performance of the Bank

As per the Articles of Associations of the Banks, the main objective is to identify, develop, promote, catalyze and support sustainable income generating opportunities and a higher quality of life for the poor through a range of activities including productive self employment micro enterprises and rural works by the provision of financial assistance and services. The following observations are made in this regard.

- (a) Out of the total assets, the Bank had maintained nearly 60 per cent as short term investments in different instruments such as fixed deposits and Repos, and the loans and advances represented only 31 per cent which was 3 per cent increased as compared with the preceding year, thus indicating that, the Bank had not adequately focused on the main objective of the Bank. Details are shown below.

Year	Total Assets	Total Loan & Advances	Percentage	Total Investments	Percentage
	Rs.	Rs.	%	Rs.	%
2017	9,535,166	2,957,368	31	5,722,837	60
2016	9,683,201	2,756,196	28	5,836,304	60

- (b) The Bank had not paid attention to achieve the rest of the objectives set out in the Articles of Association of the Bank. However, the Chairman had informed me that “the Bank operations have been done by only 04 branches and due to proposal of merger, approval has not been granted to open new branches, staff recruitments and capital expenditure etc. Hence, continue the banking operations through 04 branches and surplus invest in short term and long term instruments”

4.2 Compliance with initial Objectives of the Bank at the time of Incorporation

The following observations are made.

- (a) According to Section 1.3 of the Cabinet Paper No PED/NDTF dated 24 May 2010, the Bank should provide the relief to the depositors of the PSDB. Accordingly, the outstanding liabilities of the PSDB as at 31 December 2016 and 2017 were Rs.2,172,176,831 and Rs.1,156,988,570 respectively. These balances should be payable by the Bank as per the scheme introduced and published by the Central Bank of Sri Lanka in December 2009. However, only 1.5 per cent and 50 per cent had been settled during the year 2016 and 2017 respectively.
- (b) Out of the PSDB outstanding non-performing loan of Rs. 1,072,014,982 as at 31 December 2016, only a sum of Rs. 37,763,729 or 3 per cent had been recovered during the year under review. Accordingly the loan balances to be recovered by the Bank as at 31 December 2017 was Rs. 1,035,391,453.

4.3 Analysis of Assets base of the Bank

The total asset base of the Bank in the year 2013 was Rs. 8,011 million while it was Rs.9,535 million by the end of year 2017 representing 19 per cent growth. However, the total asset base of the License Specialized Banking Sector (LSBS) by the end of year 2013 was Rs. 919,325 million and it was Rs. 1,366,206 million by the end of year 2017 representing 49 per cent growth. Accordingly, growth rate of the Bank in terms of asset base was below the growth rate of the LSBS during the period under concerned.

4.4 Market share of the Bank

The market share of the Bank in terms of assets and deposit base as compared with licensed specialized banking sector (LSBS) are given below.

Year	Deposit based Market Share %	Assets based Market Share %
2013	0.132	0.87
2014	0.171	0.80
2015	0.122	0.83
2016	0.110	0.80
2017	0.111	0.70

Accordingly, the market share of the Bank in terms of total deposits was declined by 0.021 per cent during the period of 2013 to 2017 while the asset based market share as compared with Licensed Specialized Banking Sector during the same period was declined by 0.17 per cent.

4.5 Management Weaknesses

Even though the Bank had disclosed a sum of Rs. 2,984,843,702 as capital pending allotment under stated capital in the financial statements, necessary actions had not been taken to issue shares in respect of this capital.

4.6 Operating inefficiencies

4.6.1 Major risk areas to the Bank

The following observations are made.

- (a) According to the information provided by the Micro Finance Division of the Bank, Out of total loan portfolio of the Bank, a sum of Rs. 1,558 million or 37 per cent represented the Micro Finance Loan Outstanding as at the ended of the year 2017 and it was Rs.1,311 million or 34 per cent as at the end of year 2016. Out of these, a sum of Rs. 829 million or 53 per cent and Rs. 687 million or 52 per cent respectively had been granted to seven Community Based Organizations(CBOs) which outstanding loan balances were in excess of Rs.50 million in the year 2016 and 2017. This creates a considerable risk to the Bank due to not having securities for outstanding balances ranging from 10 per cent to 36 per cent against five loans due from respective CBOs. Details are given below

Name of the CBO	Covering by Security in the year 2017	Amount Outstanding as at 31 December	
		2017	2016
	%	Rs.	Rs.
Rathnapura District Co-op Rural Bank Union Ltd	102	65,458,509	79,755,623
Sri Lanka Ports Authority Employees' Society	14	164,765,278	83,106,944
Sri Lanka Ports Authority Employees' Welfare Society	-	-	51,400,000
Sareeram Sri Lanka National Foundation	10	53,431,557	54,594,201
Berendina Micro Finance Institute	14	289,448,706	199,282,541
Social Envo Vision Organization	36	66,950,967	58,867,076
Arthavida Intermediary Limited	18	<u>189,342,827</u>	<u>159,822,746</u>
Total		<u>829,397,844</u>	<u>686,829,131</u>

- (b) Further, out of total outstanding as at 31 December 2017, 20 per cent and 17 per cent represented the loans outstanding between the ranges from Rs. 20 million to Rs. 50 million in year 2017 and 2016 respectively.

- (c) According to the observations referred to above (a and b), the Bank had provided Rs. 1,137,409,354 or 73 per cent of its micro finance financial facilities to 15 CBOs as at 31 December 2017. Further, the Bank had provided Rs. 909,018,213 or 69 per cent of

its micro finance financial facilities to 13 CBOs as at 31 December 2016. Reliance heavily on few customers creates a high credit risk to the Bank.

- (d) The amount of loans receivable from seven CBO's which are not recovering since year 2015 amounted to Rs. 101,826,516. These borrowers had not provided any security against these loan balances creating recoverability issues to the Bank. Details are as follows.

Name of the Society	Amount Outstanding Rs.
Trincomalee Distric Gandhi Sevai Association	6,581,558
Al- Quraish Social Development	2,777,739
Sri Rohana Death Relief & Society	1,624,691
HOPE Micro Finance Services (Guarantee) Ltd.	39,373,610
Kilakkin Olichsuder Social Service Organization	1,631,045
Social Welfare Development Foundation	1,833,896
People Economics Education Development Organization	<u>48,003,977</u>
Total	<u>101,826,516</u>

4.7 Major Nonperforming Loans

According to the financial statements of the Bank for the year under review, the outstanding loan balance of Rehabilitation of Person, Property, Industries Authority as at 31 December 2017 was Rs. 53,367,652 and out of that, a sum of Rs. 51,756,336 or 97 per cent was reported as non performing as at that date.

4.8 Human Resources Management

The following observations are made.

- (a) The approved cadre of the Bank for the year under review was 183 and the Bank had deployed 116 employees at the end of the year 2017. Accordingly, there were 05 excess positions and 67 vacancies as at 31 December 2017. The Supervision Department of the Central Bank Of Sri Lanka by its letter dated 23 February 2017 had instructed the Bank to suspense all recruitments until further notice by considering the significance supervisory concern pertaining to the Bank.
- (b) It was observed that 25 Executive Level Management Posts were remained in vacant since the year 2015 and this included the posts of an Assistant General Manager, 07 Chief Managers, 03 Senior Managers, 05 Managers, a Deputy Manager and 08 Assistant Managers. Even though 07 posts of chief managers are included in the approved cadre, none of them had been recruited till end of the year under review. This may have badly effected to smooth operation of the Bank. In particular, vacant post of the senior Manager, Finance had effect to get delayed the finance functions of the Bank.

5 Accountability and Good governance

5.1 Achievement of Targets set out in the Actions Plan

The following observations are made.

- (a) The Goal 1.3 in the Action Plan prepared for the year 2017 stated the expansion of Micro Finance Institutions network Island wide by extending the enrolment of Community Based organizations (CBOs) with the Bank. But, the Bank was able to expand only 7 CBOs which was 3 per cent growth as compared with year 2016.
- (b) According to Goal 2.1 in the Action Plan, the Bank had planned to develop suitable new savings products in the year 2017 to attract rural urban middle and lower income people. However, the Bank was able to achieve the net savings of Rs.160 million or 17 per cent growth as compared with year 2016. Further, no savings product had been introduced in the year 2017.
- (c) The Bank had not set out any target to recover the PSDB loan in the Action Plan prepared for the year under review though it had non performing loan balance of Rs.1,035,391,453. Further, fruitful actions had not been taken to recover these loans by disposing assets of the PSDB.
- (d) The following targets set out in Action Plan for the year under review had not been achieved as expected.

Item	Target	Actual Achievement
Increase of Performing Loans and Leasing	Rs.3.181Bn	Rs.2.165 Bn
Maintain Return on Assets	7%	6.28%
Maintain Profit before tax	Rs.615.5 Mn	Rs.603.5 Mn
Decrease of Government Treasury Bill & Bond	Rs.396 Mn	Rs.914 Mn
Increase of Leases and Higher Purchases	Rs.684 Mn	Rs.515 Mn

6. Systems and Controls

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

Areas of Control	Observations
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(a) Control over Loans	Attention to be paid to mitigate non - performing loans.
(b) Maintenance of Bank Accounts	The Bank should implement a sound process to prepare bank reconciliation statements as there were considerable number of unposted entries were noted.
(c) Settlement of PSDB Liabilities	Priority should be given to settle the outstanding balances.
(d) Compliance with Provisions in the Companies Act.	The Bank shall comply with the time requirements in conducting of annual general meetings and furnishing the annual returns.