

## National Savings Bank - 2018

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### 1.1 Opinion

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The audit of the financial statements of the National Savings Bank (“Bank”) and the Consolidated Financial Statements of the Bank and its Subsidiary (“Group”) for the year ended 31 December 2018 comprising the statements of financial position as at 31 December 2018 and the statements of comprehensive income, statement of changes in equity and cash flow statement 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 and Finance Act No. 38 of 1971.

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 2018, and of their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### 1.2 Basis for Opinion

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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

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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 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 intends 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 Auditor's Responsibilities for the Audit of the Financial Statements

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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 Group'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 Group'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 Group 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 Accounts Receivable and Payable

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### 1.5.1 Receivables

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Audit Issue	Management Comment	Recommendation
(i) Receivable amount to the Bank from fraudulent withdrawals as at 31 December 2018 is Rs.110.5 million and this indicates Rs.15.7 million or 16.6 per cent increase compared to the previous year. The fraud occurred in Head office Branch in 2018 mainly causes to increase this receivable balance. Out of the above balance Rs.85 million had remained outstanding for more than one year and a sum of Rs.29 million had remained outstanding for over five years period.	Action are being taken to clear the balances, and an adequate provision of Rs.86 million has also been made as at 31 December 2018 against the total fraudulent withdrawal of Rs.110.5 million.	Take necessary actions to get recovered the long outstanding balances.
(ii) The Bank had invested money on treasury bond of Entrust Securities PLC in 2016 and the capital and interest receivable balance of Rs.153.6 million had not been received up to the date of audit of 30 June 2019.	Noted.	Take necessary actions to get recovered the receivable balance.

## 1.5.2 Advances

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Audit Issue	Management Comment	Recommendation
(i) The total outstanding loan and advance balance as at 31 December 2018 was Rs.329,131 million and out of that Rs.5,212 million or 1.6 per cent shown as non-performing loan balance as at that date and this was Rs.299,304 million and Rs.4,987 million in year 2017. Further, out of non-performing loans as at 31 December 2018, a sum of Rs.143 million or 2.7 per cent was remaining outstanding for more than 3 years.	Noted.	Take necessary actions to recover the non-performing loans of the Bank.
(ii) The Bank had repaid the USD 750 million bond which was matured on 17 September 2018. The USD loan issued to General Sir John Kotelawala Defence University (KDU) was due to be matured on 17 September 2018. However they were unable to make the payment on maturity and Bank had to obtain another foreign loan of USD 100 million from Commerzbank of Germany at an interest rate of Variable+2% for a period of 3 years in order to repay the bond.	Noted.	Ensure that all due amounts are recovered from relevant customers which need for the smooth operations of the Bank.
(iii) As per the cabinet memorandum dated 25 March 2019 submitted by Ministry of Defense, approval was granted to extend the tenure of the existing treasury guarantee issued on loans granted to General Sir John Kotelawala Defense University (KDU) by covering the reschedule amount. However treasury guarantee had not been received up to now. Even after rescheduling the loan, the customer was unable to pay loan installment on due time and penalty of Rs.56 million and USD 19,364 respectively on LKR and dollar loans were imposed on customer. However it had not been paid even up to date.	Noted.	Ensure that all due amounts are recovered from relevant customers on time and take necessary action to extended the remaining treasury guarantee amount and period.

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| <p>(iv) Total pawning advances given by the bank as at 31 December 2018 was Rs.28,010.16 million and market value thereon was Rs.49,808.78 million. Out of the total pawning advances, Rs.233.72 million represents non performing pawning advances as at 31 December 2018. Age analysis of non-performing advances further revealed that Rs.211.46 million had remained outstanding for a period of 1 to 3 years and Rs.22.25 million had remained outstanding over 3 years period.</p> | <p>The NPL ratio of pawning has reduced to 0.78% from 0.83% as at 31 December 2018. Due to the legal cases and pending investigations, some of the pawning advances remain outstanding for over three years.</p> | <p>Take necessary actions to recover the non-performing pawning advances of the Bank.</p>   |
| <p>(v) Advances paid to suppliers aggregating to Rs.8.15 million remained outstanding for more than one year period and out of that Rs.4.08 million had been recovered in September 2019 and the balance remained outstanding even as at the date of audit.</p>  | <p>A sum of Rs.4.08 million has been recovered as at 25 September 2019 and action has already been taken to clear the remaining balance of Rs.4.07 million as at 31 December 2018.</p>                           | <p>Ensure that all due amounts are recovered from relevant suppliers.</p>   |
| <p>(vi) A personal loan of Rs.900,000 had been granted by the Bank on 11 May 2012 to a particular customer. The file containing the original documents of this loan was misplaced. Only two installments had been recovered and no investigation was carried out against the officer in charge of loan files. No legal action had been taken to recover the loan as per section 8 and 9 of the Loan Recovery Policy of the Bank or from guarantors.</p>                                  | <p>Noted.</p>  | <p>Take necessary legal actions against offenders and strengthen the internal control to ensure the safeguards of security documents. Take necessary actions to recover the due amount.</p> |

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

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Reference to Non-compliance Laws, Rules Regulations etc.		Management Comment	Recommendation
<b>National Savings Bank Act, No.30 of 1971</b>	Deposits which are inoperative over 10 years should transfer to the "Unclaimed Deposits Reserves" account. However it was observed that Rs.676.24 million remained as dormant in financial statements as at 31 December 2018 without transferring to the said reserve.	Bank has transferred a sum of Rs.2,001 million lying to the credit of dormant / unclaimed deposit account in 2018. Due to the higher percentage of subsequent payments to the customers, transfers are made periodically. The remaining balance will be considered for the next year transfers.	Ensure strict compliance with the said direction.
i) Section 47			
ii) Section 47(4)	Payments made to customers from the Unclaimed Deposit Reserves Account shall get reimbursed as soon as possible from the Secretary to the General Treasury out of the Consolidated Fund to the Bank. The Bank had paid Rs.474.18 million during the period from 2000-2018 to customers from unclaimed deposit reserve account. Out of that amount the Secretary to the General Treasury had reimbursed Rs.300 million during the year 2019 and the balance had not been recovered up to the date of audit.	Requests have already been made to the Treasury and this is being followed. A sum of Rs.300 million has received from the General Treasury for the reimbursement of dormant during the year 2019.	Take necessary actions to get reimbursed the due amount from treasury.

## 2. Financial Review

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### 2.1 Financial Result

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The operating result of the year under review amounted to a profit of Rs.4,500 million and the corresponding profit in the preceding year amounted to Rs.9,716 million. Therefore a deterioration amounting to Rs.5,216 million of the financial result was observed. The reasons for the deterioration are the decrease in net interest income, net gain from trading, net other operating income and increase in impairment charges and personal expenses.

## 2.2 Trend Analysis of major Income and Expenditure items

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Net interest income of the Bank has decreased by Rs.249 million or 1 per cent as compared with the previous year. Non consideration of notional tax relating to the nine month period in 2018 and increase of cost of deposit due to increase in fixed deposit interest rates were the main reasons affected for the reduction. Net gain from trading has also declined by Rs.1,913 million or 159 per cent due to declining the fair value of equity and government security portfolio of the Bank. The net operating income has declined by Rs.630 million or 37 per cent compare to the previous year due to non-declaration of dividend by NSB Fund Management Company for 2018. Impairment charges for loan and other losses has increased by Rs.105 million or 14 per cent due to converting impairment provision method from incurred loss approach to expected credit loss approach. Personal expenses of the Bank has increased by Rs.2,376 million or 35 per cent due to salary increments granted to employees as per the collective agreement with effect from 1 January 2018 and absorption of some contract basis employees in grade VI and VII into the permanent cadre during the year 2018.

## 2.3 Ratio Analysis

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Following observations are made on some important accounting ratios of the Bank for the year under review as compared with sector ratios in this regard.

- (i) The Return on Equity (ROE) ratio and Return on Asset Ratio of the bank had been decreased by 16.87 percent and 0.69 percent respectively in 2018 as compared with previous year mainly due to low profitability during the year under consideration.
- (ii) The Liquidity Assets Ratio also had decreased by 18.5 percent in 2018 when compared with the previous year. However the ratio is above the industry average of 47.7 per cent.
- (iii) Total Capital Adequacy Ratio of the Bank reported as 16.14 per cent as at 31 December 2018 which is higher than the minimum statutory requirement of 12.875 per cent.
- (iv) The net interest margin of the Bank in 2018 had reduced by 0.19 per cent as compared with the previous year.

### 3. Operational Review

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#### 3.1 Uneconomical Transactions

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Audit Issue	Management Comment	Recommendation
<p>A sum of Rs.35.23 million had been spent since 2008 to build 18 storied building in Head office premises of the Bank which construction work had been abandoned. Hence, the expenditure incurred thereon had become a fruitless expenditure.</p>	<p>The project for 18 storied building has been initiated with the outside professional institution including the Central Engineering Consultancy Bureau (CECB) and this capital expenditure represents the payment made to them for their professional services.</p> <p>Further, the Urban Development Authority (UDA) has agreed to allocate a block of land owned by them adjoining to Head Office building for 50 year lease. The possibility of obtaining the land from UDA was explored followed by several discussions and accordingly the major developments at the Head Office premises will be planned later.</p>	<p>Take necessary actions to write off the balance after obtaining necessary approvals.</p>

#### 3.2 Identified Losses

Audit Issue	Management Comment	Recommendation
<p>An employee worked at Head Office Branch had fraudulently created 16 forged loans and the disbursements had been credited to 16 saving accounts created by him using forged identity cards during the period of November 2016 to August 2018. The financial loss incurred by the Bank due to this fraud was Rs.25.6 million. The culprit was suspended from Bank service and remanded. The court examination is ongoing under the Case No. 11288/18 at the magistrate Court, Colombo Fort against the defendant. Another five officers were identified as responsible for the above fraud due to acting negligently and recommended to take necessary</p>	<p>We noted your comments regarding the losses. Only 32 no. of files have been misplaced in the Head Office Branch out of which 16 files are forged loan files.</p> <p>Instructions have already been issued to the Branches to log-out from the system after performing the relevant</p>	<p>Take necessary actions to strengthen the internal control system of the Bank to avoid such types of fraudulent activities in the future.</p>



disciplinary actions against them through the functions. Furthermore, investigation report dated 30 January 2019. It was revealed that, 32 no. of loan files have been misplaced in the Head Office Branch out of which 16 files are forged loan files.

### 3.3.1 Operational Inefficiencies

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Audit Issue	Management Comment	Recommendation
<p>(i) The object of the bank in terms of Section 2(a) of the National Savings Bank Act No 30 of 1971 and amendments thereto, shall be the promotion of savings among people of Sri Lanka, particularly among those with limited means, and the profitable investment of savings so mobilized. Following observations are made by comparing the deposit (savings) base of the Bank, with the Banking Sector and Licensed Specialized Banking Sector for the period of 2010 to 2018.</p> <ul style="list-style-type: none"> <li>▪ Though total deposit base of the Banking Sector had improved by 228 per cent from year 2010 to 2018, NSB achieved a deposit base growth of only 136 per cent during the said period. Therefore the market share of NSB has deteriorated from 13.7 per cent in 2010 to 9.9 percent in 2018.</li> <li>▪ Market share of NSB with compare to the licensed specialized banking sector also deteriorated from 82.1 per cent in 2010 to 77.4 per cent in 2018.</li> <li>▪ The Year on Year growth of the deposit base of the Bank was below the Year on Year growth of the banking sector during the period under concern which would be a less achievement of the object of the Act.</li> </ul>	Noted.	Ensure that all necessary actions are taken to maintain the deposit base growth rate of the Bank in compatible with the market growth rate.

- As well the Bank had not been achieved its target on Year on Year growth set out in their corporate plan except the year 2010/2011.
- (ii) The equity trading portfolio of the Bank as at 31 December 2018 consists of 41 stocks of listed companies in Colombo Stock Exchange with fair value of Rs.3,273 million which indicates a marked to market loss of Rs.1,552 million. As well no transactions had been done after the year of purchase with nine companies on which Rs.1,169 million investment made.
- Noted
- Take necessary actions to maintain an equity portfolio which brings profitability to the Bank.

### 3.4 Idle or Underutilized Property, Plant and Equipment

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Audit Issue	Management Comment	Recommendation
Although the land with an extent of 38.8 perches was leased from the Urban Development Authority in the year 2008 for a 50 year period, this land had not been properly used for last 10 years.	The leased UDA Land with an extent of 38.8 perches has not been utilized for permanent developments as this land was identified by the UDA for settlement of families from 106 perch adjoining land which is identified for long term lease from the UDA. However, arrangements are now being made to construct a multi-storied building on this premise.	Utilize the land for an effective work of the Bank.

### 3.5 Resources Released to Other Organizations

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Audit Issue	Management Comment	Recommendation
<p>As per paragraph 9.4 of PED 12, an employee of an enterprise should not be released to a Ministry or any other institution without the approval of cabinet and the enterprise should not pay any emoluments to the released employee during such period. However during the year 2018, opposed to the instructions given under above circular eight employees had been released to four ministries.</p> <p>Proper documents relating to the release of particular employee had not been included in their personal files. Total expense of Rs.6.12 million had been incurred by the Bank to pay the remuneration, overtime, bonus, medical and leave encashment of released employees. However this amount had not been reimbursed by the relevant ministry.</p>	<p>Eight employees who have been released to the Ministries were called back to the Bank's service. Accordingly, they assumed duties in the Bank in October, November and December 2018. At present, the Bank has not released any employee to the Ministries.</p>	<p>Ensure strict compliance with the said direction when releasing resources to other organizations.</p>

### 3.6 Human Resources Management

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Audit Issue	Management Comment	Recommendation
<p>(i) The approved cadre of the Bank was 4,978 employees as at 31 December 2018. Following observations are made in this regard.</p> <ul style="list-style-type: none"> <li>▪ The actual cadre of the Bank as at 31 December 2018 was 4,512 which consist 4,262 permanent staff and 250 contract basis employees. Therefore 466 posts are vacant at that date.</li> <li>▪ Although the approved cadre for Executive Grade was 870 as at 31 December 2018, the actual cadre was 570 which consist of 565 permanent employees and 5 contract basis employees.</li> </ul>	<p>236 promotions were granted during the year 2019 to fill the vacant positions in the Executive category which includes 7 AGMM, 21 Chief Managers and 42 Senior Managers, 61Managers and 156 Asst. Managers in both Banking and Non-Banking streams. Further, the Manpower Plan of the Bank has been revised for the year 2019 considering the requirements of all branches and divisions of the Bank. Accordingly, arrangements have been made to fill the vacant positions by way of recruitment and internal promotions.</p>	<p>Take necessary actions to fill the vacant positions which need for the smooth operations of the Bank.</p>

- 300 posts or 34 per cent of approved cadre in the Executive level were remained vacant at the end of the year 2018. Six Assistant General Managers, 26 Chief Managers, 7 Senior Managers, 12 Managers, 235 Assistant Managers and 8 Confidential Secretaries were included in the above vacant position. This may have an implication to smooth operation of the Bank. However 236 promotions were granted during the year 2019 to fill the vacant positions in the Executive category.

(ii) Following observations are made with regard to the recruitments to the posts of Staff Assistant (Grade VI) and Office Assistant (Grade VII).

- Out of 5,406 number of approved cadre of the Bank, the cadre approved for the Staff Assistant and Office Assistant posts were 2,066 and 563 respectively. Accordingly 48.6 per cent (%) of the total cadre was allocated for the above posts.

The recruitments to the above posts are done by using lists forwarded by the ministry and management, without publicly calling applications from qualified candidates. Therefore it was observed that it is unfair for the whole masses who are seeking jobs in the Sri Lankan job market.

- During the period of 2018/2019, 39 candidates had been recruited as trainees with the purpose of absorbing into the post of staff assistant after 6 month training period and 1 years contract period.

Recruitment of Trainees and Office Assistants were made to fill the vacancies existed in the Approved Cadre in 2018 and 2019 with the approval of the Board of Directors. However, a decision has been taken to adopt a transparent mechanism to such recruitments in future.

Ensure that uniform and transparent recruitment procedure is introduced for grade VI and grade VII employees.

During the same period 37 numbers of candidates had been recruited on contract basis with the purpose of absorbing into office assistant post. Those recruitments are solely based on the lists provided by the ministry as well as management and no any transparency was observed in the recruitment process. As at 31 July 2019, total employees waiting to absorb into staff assistant and office assistant posts are 146 and 62 respectively.

- (iii) It was observed that five employees had not been satisfied the minimum requirement qualifications necessary for their recruitments.

Noted

Ensure that all the persons recruited are satisfied required qualification as per Recruitment Procedure of the Bank.