

NSB Fund Management Company Limited -2021

1.1 Opinion

The audit of the financial statements of the NSB Fund Management Company Ltd for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 and the statement 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. My comments and observations which I consider should be reported to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Opinion

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

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 Company'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 intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company 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 Company.

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 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 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 Company'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 Company'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 Company 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 Company, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and

- Whether the resources of the Company 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

1.5.1 Receivables

Audit Issue	Management Comment	Recommendation
The Company was appointed as a lead manager for reorientation of Sri Lankan Airlines project in the year 2016 by the Cabinet of ministers. In this regard, receivable balance from the treasury was Rs.246,939,587 and out of such balance, an amount of Rs.88,939,587 had remained outstanding as at the end of 2021.	Noted We have made number of requests so far. The latest request was sent on 27.05.2022	Company should recover the receivable amount from the treasury.

2. Financial Review

2.1 Financial Result

Net Profit of the Company had been decreased from Rs.608 million in 2020 to Rs.6 million in 2021. Therefore, a deterioration amounting to Rs.602 million or 99.01 percent of the financial result was observed. The main reason for this deterioration was incurring net loss from financial instruments at fair value through profit and loss by 1,087 million or 230 percent when compared with previous year.

2.2 Trend Analysis of major income and expenditure items

Trend Analysis of major income and expenditure items of the year under review compared with the preceding year with the percentage of increase or decrease is as follows

Description	Variance Favorable/ (unfavorable) (Rs.)	Variance (%)	Reasons for Variance
Interest Income	(58,474,269)	(3.9)	Maturity of some higher coupon bonds in the year 2021.
Interest Expense	(98,319,993)	(10)	Decrease of interest on repurchase agreement.
Fee Income	(3,096,655)	(5.87)	Completions of trustee agreement during the year 2021.

Net Trading Gain/ (Loss)	(1,087,037,762)	(230.47)	Increase of market interest rates in 2021. Hence, average market yield of the portfolio has increased from 5.62% at the beginning of the year to 9.27% at the end of the year by 365 bps.
Personal Cost	10,803,121	38.15	Revision of salary averagely by 15.5% for the permanent staff, granted promotions to existing staff and recruiting of four new employees in the year 2021.

2.3 Ratio Analysis

Following observations are made in some important accounting ratios of the Company for the year under review as compared with Sector ratios.

Description	Sector		Company	
	2021	2020	2021	2020
Return on Equity (ROE) (%)	-3.2	30.5	0.17	16.96
Return on Asset (ROA) (%)	-0.7	7.6	-0.13	5.48
Risk Weighted Capital Adequacy Ratio (RWCAR) (%) (Minimum 10%)	42.8	27	22.36	35.01

3. Operational Review

3.1 Human Resources Management

Audit Issue	Management Comment	Recommendation
a. The Company does not have a Scheme of Recruitments (SOR) for the employees which includes nature of position, responsibilities & rights, educational & professional qualifications, method of recruitments etc,	<p>All vacancies for new recruits whether they are for permanent or contract positions should be processed through Human Resource Development Division (HRD Division) of the Bank if the recruitment is filled on secondment basis using the Bank Staff and it should be reviewed and approved by the Board of Directors of NSB FMC.</p> <p>All vacancies for new recruitment whether they are for permanent or contract positions should be processed through the BHRRC of the NSB FMC if the recruitment is directly to the NSB FMC.</p>	<p>Company should prepare a formal Scheme of Recruitment (SOR) immediately which includes methods of recruitments and promotions, qualifications, experience etc for each position.</p>

The Scheme of Recruitment are included in the NSB FMC HR Policy (page no 04) which was already approved by the Board of Directors of NSB FMC.

- b. There is no designated officer for performing human resource management functions of the Company. The NSB FMC will make arrangement to recruit an Officer to perform HR functions. Take necessary arrangements to recruit an officer for Human Resource functions.
- c. Although the Company carries out its operations under front, middle and back office, there is no separate Finance Division with sufficient staff to perform financial functions under proper control. Accountant (Ms.H.N.O.M.Somasiri) and Investment Assistant-III Ms.A.A.K.Weerasekera) already assigned to perform the financial functions of the NSB FMC. Further, the Board of Directors at its meeting held on 12/10/2022 approved to absorb employees to the NSB FMC on secondment basis from Sri Lanka Savings Bank, out of which, one employee is to perform the financial functions of NSB FMC. Separate financial division should be established to perform financial functions effectively.
- d. It was observed that the Company had recruited 07 employees during the period of 2020-2021 and 06 employees (85 percent) of those recruited employees have been resigned from the company during the period of 2021-2022. Attention has not been taken to reduce the high staff turnover of the Company. The employee has resigned from the NSB FMC with reasons of migration, Salary level and personal etc. Staff turnover ratio should be minimised. Accordingly, NSB FMC has taken steps to recruit new employees for the vacant positions. Further, the Company has revised the salary levels of the staff to address the employee turnover.
- e. The Board of Directors of the Company had advised the CEO to formalize the Management Committee of the Company through Board of NSB since the Management Committee of the Company has consisted of the Senior Management of the Bank. Upon that, the CEO of the Company has sent an internal memo dated 08 March 2021 to the Board Secretary- NSB to get the NSB FMC will make arrangement to formalize the Management Committee an immediately. Management Committees should be formalised.

consent of the Board for the above matter and, the Board of Directors of NSB had inter alia noted in relation to the Board Paper No: 108/2021 on 30 March 2021. However, the Management Committees had not been held for the year under review with the appointment of senior officials of NSB.

- f. A trainee had been recruited for the covering up duties of an officer (Investment Assistant II) who was released to the NSB Treasury Back Office for 03 months. However, upon the resignation of the said officer, that trainee was appointed to the position of Investment Assistant II for the period of six months on contract basis with effect from 01 May 2022. The following observations were made in this regard.
- Mr. Biyumal Dissanayake Joined with the NSB FMC as a “Trainee” commencing on 11/11/2021.
 - The Board of Directors of NSB FMC at its meeting held on 01/02/2022 approved to release Ms. Gayani Sewwandi (Investment Assistant III) to the Treasury Back Office of NSB on temporary basis for the period of 03 months and to assign Mr.Biyumal Dissanayake (Trainee) to cover the duties of above Officer -Investment Assistant III under the supervision of Senior Manager Back Office.
- i. The aforesaid trainee was deployed for 06 months from 11 November 2021 to 10 April 2022 and the re-appointment was given on 01 June 2022 by CEO of the Company. Thus, this officer had been deployed for the period from 11 April to 31 May 2022 without legal appointment.
- With completion the training period, considering the recommendation of the Senior Manager – Back Office and based on the performance during the training period, the CEO –NSB FMC has submitted a paper dated on 12/04/2022 to the BHRRC for seeking recommendation for the absorption of Mr. Biyumal Dissanayake as the Investment Assistant of NSB FMC with effect from 01.05.2022.
- ii. Upon the request of Acting DGM (Finance, Corporate Planning & MIS) of NSB on 20 January 2022, the Board of the Company has given approval to release an Investment Assistant-II to NSB Treasury Office and recruit a trainee for the covering up duties of said
- The BHRRC of NSB FMC at its meeting held on 19/05/2022 has reviewed the submitted paper and recommended to the Board of Directors for its recommendation/approval.
 - Based on the recommendation of the BHRRC the Board of Directors at its meeting held on 20/05/2022 suggested to
- Company should follow formal recruitment procedure under formal SOR which specify the methods of recruitments and promotions, qualifications, experience etc for each position.

officer for the Board Paper submitted on 01 February 2022. However, it was observed that this trainee had been recruited to the Company on 11 November 2021 prior to this approval.

absorb Mr. Biyumal Dissanayake as the “Investment Assistant” with effect from 11/11/2021.

- Subsequently, on the Board meeting held on 24/05/2022, CEO- NSB FMC explained the practical difficulty of absorbing Mr. Biyumal Dissanayake into the position of Investment Assistant on contract basis commencing from 11.11.2021, since he initially joined the company as a Trainee, and he was paid an attendance allowance. Therefore, the CEO NSB FMC suggested to consider his contract period starting from 01.05.2022 for a contract period of 06 months.
- Accordingly, the Board of Directors suggested and approved to absorb Mr. Biyumal Dissanayake as the investment Assistant of NSB FMC starting from 01/05/2022 subject to the contract period of 06 months.
- The appointment letter of Mr. Biyumal Dissanayake, has been issued on 01/06/2022 with informing his recruitment as the “Investment Assistant” of NSB FMC subject to the contract period of six months commencing on 01/05/2022.

3.2 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
<p>a. Although the Direct Dealer Participants’ policy on haircuts for the repurchase and reverse repurchase transactions should be disclosed in its annual audited financial statements according to Section 7.1 (iii) of Registered Stock and Securities Ordinance and Local treasury Bills Ordinance Directions No.01 of 2019 dated 20 December 2019, the Company had not adhered to it.</p>	<p>Noted We will disclose in Annual Financial Statements 2022. If the issue was identified at the time, we submitted the draft Financial Statements 2021 to the Audit, we could insert it in the same.</p>	<p>The company should comply with relevant regulation when conducting operations.</p>

- b. There were some instances where no authorization was given for the deal tickets and deal reference number had not placed on the face of deal ticket contraction to the approved operational manual. Noted and will take necessary actions. Company should adhere to formal internal control procedures which has previously formulated.

4. Accountability and Good Governance

4.1 Annual Action Plan

Audit Issue	Management Comment	Recommendation
a) Though the Company had planned to introduce Mobile app for customer convenience in the year 2019, it was not yet introduced.	Customer Management System is implemented in 2022 and preferred customers can join through the online platform.	Company should complete planned activities within planned period.
b) With an aim to strengthening the internal processes, the company has planned to acquire a new Treasury Management System by 2019 and create Research & development unit by 2020. However, it was unable to complete the above aims even up to the date of audit of June 2022.	Due to Covid 19 pandemic prevailed in the world, the technical staff allocated to treasury system development had returned to India and their team has been changed many times. Therefore, development was not happened speedily as expected. However, we have given 30.09.2022 data to migrate to the live system and expect to complete the Go Live process in December 2022.	New Treasury Management system should be completed immediately.