

## **People's Bank and its subsidiaries – 2021**

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### **1. Financial Statements**

#### **1.1 Opinion**

The audit of the financial statements of the People's Bank (the "Bank") and the Consolidated Financial statements of the Bank and its subsidiaries ("Group") for the year ended 31 December 2021 comprising the statement of financial position as at 31 December 2021 and the statement of income, the statement of comprehensive income, statement of changes in equity and statement of cash flow 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 report to Parliament appear in this report.

The Bank has been exempted from the provisions of Part II of the Finance Act, No. 38 of 1971 by an Order of then Minister of Finance published in the Government Gazette No. 715 of 14 May 1992 by virtue of powers vested in him by Section 5(1) of the said Finance Act.

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 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 Bank's and 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 intend to liquidate the Bank and 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 Bank and 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 Bank and the Group.

#### **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 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 Bank's and 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 Bank's and 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 Bank and 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 Audit observations on the preparation of Financial Statements

### 1.5.1 Suspense Accounts

Audit Issue	Management Comment	Recommendation
➤ Accumulated balance amounting to Rs.2,783 million was remained in outstanding more than one year without clearing.	As at 14.11.2022 Rs. 1.968 Bn out of Rs. 2.783 Bn has already been capitalized.	Recommended to clear, long outstanding suspense accounts within relevant timelines. Need to take follow up actions on long outstanding un cleared suspense account balances.
➤ An advance payments made to Just in Time (PO 21458) for Data Ware House Project and Innova IT systems for Application rewrite program (PO 25629) amounting to Rs.137.19 million and Rs.47.03 million respectively were fully provided for losses at the end of year 2021.	An advance payment of Rs. 168.66 Million was made to Just in Time (PO21458) for Data Warehouse Project as per the Scope of Work agreement, and project was terminated at license expiration and therefore, fully provided for losses at the end of year 2021.	Need to be more concern on the economical decisions and need to do feasibility study prior to make such decisions.
	<p data-bbox="702 1702 1133 1780"><u>Advance payment to Inova IT Systems (PO25629)</u></p> <p data-bbox="702 1803 1133 2027">An advance payment of Rs. 47.03 Million was made to Inova IT Systems (PO25629) for Application Re-write Program. At the time of provisioning certain areas needed to be</p>	

developed. At present all the systems under Re-Write project are on live operations and certain developments were made with the involvement of In-house development team. As per the agreement, monthly payments were done for development services by Inova-IT. As the systems are on live operation at present with the required developments, a potential reversal could be made for the provision made.

- It was observed that GL account balance is more than the trial balance by Rs.84.63million which incurred as expense of digitalization project.

LKR 84.63 Million was paid on Digitalization project, based on the board approval.

Board approval can't be accepted as supporting document to prove occurrence of expenditure. Hence need to be incurred all the expenses that can be proven the occurrence. Further need to be carry out proper investigation on the root cause of incurring this expense.

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

Audit Issue	Management Comment	Recommendation
<p>According to the Paragraph 2 of Public Enterprise Circular No PED 03/2016 dated 29 April 2016, board of directors and higher management of public enterprise shall be responsible to deduct the PAYE tax applied for employees and remit the same to the Inland revenue Department. However, the collective agreement signed between the state Banks and the respective Trade Unions directs to pay the income tax liability of the employees by the Bank without being deducted from the employees' salary. Based on that, the Bank has paid Rs.56.86 million as PAYE tax on behalf of employees from bank's funds without deducting from employees' earnings as at 31/12/2021 for the year of assessment 2021/22.</p>	<p>Seek to point out the following.</p> <ul style="list-style-type: none"><li>a) As per the Cabinet decision exempting People's Bank from Part II of the Finance Act No.38 of 1971 and all Treasury and Public Administration circulars.</li><li>b) As per the collective agreement(s) entered into between the Bank and the Trade Unions relating to the period(s)/ salary cycle 2021 to 2023 and 1991 to 1993.<ul style="list-style-type: none"><li>- In this context, seek to point out the following:<ul style="list-style-type: none"><li>a. Draw specific attention to clause(s) 6 and 14, respectively therein, which is self-explanatory. It sets out the ultimate liability relating to PAYE tax on emoluments</li><li>b. As self-evident in the said two (2) agreements, this practice has been existence for close to thirty (30) years</li><li>c. Similar collective agreement(s) applies to <u>also</u> Bank of Ceylon and National Savings Bank. To save any future doubt, all related negotiations are carried out in <u>concert</u></li><li>d. Same benefit applies to all Bank staff</li></ul></li></ul></li></ul>	<p>Need to adhere with PED circular.</p>

## 2. Financial Review

### 2.1 Financial Result

The operating result of the year under review amounted to a profit before tax of Rs.30,386.6 million and the corresponding profit in the preceding year amounted to Rs.21,226.7 million. Therefore, an improvement amounting to Rs.9,159.9 million or 43.15 percent of the financial result was observed. The main reasons for the improvement are increment in net interest income, net fee & commission income and other operating income.

### 2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the year under review as compared with the preceding year with the percentage of increase or decrease are given below.

Description	Variance Amount Increase/ (Decrease) (Rs'000)	Variance (%)	Reason for the Variance
Interest Income	17,612,485	9.8	Increase in the average balances of Overdrafts, Term Loans, MMFC placements STL import loans
Interest Expense	(3,914,573)	3.3	Reduction in the cost of funds due to rate cuts despite the increase in the average balance of interest bearing liabilities
Other Expenses	1,941,843	12.7	Increase in advertising and business promotion comparing to last year , Deposit insurance premium plus Depreciation
Impairment Charge	2,905,646	25.1	Additional provisions made on Loans & Advances plus PD on ISBs increased to 30 percent.
Value Added Tax (VAT), Nation Building Tax (NBT) and Debt Repayment Levy (DRL) on financial services	3,010,444	78.2	Increase in Profits and Emoluments
Personnel Expenses	3,049,568	15.5	Salary increment as per collective agreement 2021-2023 plus Increase in Incentive (2.5 Months in 2021 an 1 Month in 2020)

## 2.3 Ratio Analysis

According to the information made available, certain important ratios of the Bank for the year under review and the preceding year are given below with the comparison to the Sector Ratios published by the Central Bank of Sri Lanka.

Description	Sector Ratio	Bank	
		2021	2020
<b>Performance Ratios</b>			
Return on Equity (ROE)	13.8	19.9	14.3
Return on Assets (ROA)	1.6	1.3	1
Interest Margin	3.3	3.4	2.9
<b>Assets Quality Ratio</b>			
Gross Nonperforming Advances (NPL)	4.3	3.2	3.3
<b>Capital Adequacy Ratios</b>			
Tier 1 Capital(Minimum 8.5%)	13.2	12.6	9.5
Total Capital(Minimum 14%)	16.7	17.8	15.5
<b>Statutory Ratio</b>			
Liquid Assets Ratio (Minimum Requirement 20%)	30.9	23.52	25.61
Liquidity Coverage Ratio (Minimum Requirement 100%)		Rupee – 155.83 All currency – 105.71	Rupee - 166.82 All currency - 111.55

## 3. Operational Review

### 3.1 Uneconomic Transactions

#### Audit Issue

#### 3.1.1 Data Warehouse and Business Intelligence System Project

The bank had decided to introduce Data Warehouse and Business Intelligence System (DWH & BI) in year 2011. A feasibility study was not done even though the bank has called Expression of Interest (EOI) from the vendors and called Request for Proposals (RFPs) from shortlisted

#### Management Comment

Noted the comments.

Even though feasibility study was not done, Data Warehouse Project was initiated as a futuristic approach with the approval of Board of Directors with the participation of external consultant and Technical committee members comprised from University of Colombo & University of

#### Recommendation

Although bank had incurred cost on this system, at present bank doesn't use it for operations. Since bank operate with public money, management decisions of the bank need to be more economic to the bank

vendors. Board of directors had approved the decision of selecting Just In Time (JIT) at initial cost of Rs.250,539,918. The Bank had entered into the agreement with JIT on 02 November 2015 for a total cost of Rs.419,389,981 including the maintenance cost of Rs.168,850,063 for next five years. Though the bank had quoted price in both currencies of USD and LKR as per the final price schedule in the agreement, bank had to pay Rs.36, 462,590 more than the agreed amount in LKR due to rupee value depreciation against the USD. Moreover, amount of Rs.1, 467,787.86 was paid for change request to the system in addition to the agreed cost since these changes not identified at the initial stage. Eventhough the bank has incurred Rs.405,757,212 (after tax) as at 30 May 2022, the project was hold and not in use for operations due to expiration of license, not updating according to the changes of upgraded systems, using alternative methods for data gathering instead of using the Data Warehouse system and prepare reports for their own formats.

Moratuwa.

At the time of agreement 1 USD = Rs.133 where it has increased about 3 times at present approximately 1 USD = Rs. 360.

Over the time, requirements changed and new requirements were arisen. The change requests worth of Rs 1,467,787.86 was paid for the new requirements/ changes needed at present, where incorrect output is of no value to the Bank.

Just In Time Technologies (JITT) was selected by an evaluation with the lowest quote and as the required mandatory/ desirable module submission provider.

PB Management has taken proactive actions to discuss and price negotiations with vendor and to enter into a favorable agreement with license renewal for next period of time to complete the project. However, the proposal received from the vendor was not accepted by the Bank, and therefore the project was discontinued after license expiration without a renewal.

In order to fulfill this gap of Data Warehouse, the Bank decided to move forward with an in-house solution to consolidate data from numerous information systems and to produce own reports and dashboards with a new S/W tool. The selected S/W tool 'Tableau' evaluation is in progress. Selected number of servers used for Data Warehouse solution was planned to re-use under this solution with a new Service Level Agreement (SLA) for the beneficial of the Bank.

without any exceptions.



### 3.2 Identified Losses

Audit Issue	2021			2020			Management Comment	Recommendation
	Loss Event	No of Events	Value Rs.Mn	Percentage of Total Value	No. of Events	Value Rs.Mn		
Internal Frauds	4	52.64	23.48	1	0.43	0.06	Root-cause analyses for the highlighted incidents have been conducted and the recommendations to avoid/minimize these types of events in future were discussed in depth at the Operational Risk Management Committee meetings.	Need to adhere with internal control systems.
External Frauds	100	121.07	54	181	735.50	95.50		
Client ,Product, and business practices	0	0	0	1	23.01	2.99	The disciplinary actions have been taken /initiated over the reported incidents as detailed below;	
Damage to physical assets	6	0.37	0.17	4	0.51	0.07		
Business disruptions and system failures	4	0.35	0.16	7	0.23	0.03		
Execution ,delivery, and process management	103	49.79	22.21	96	10.50	1.36		
<b>Total</b>	<b>217</b>	<b>224.22</b>	<b>100</b>	<b>290</b>	<b>770.18</b>	<b>100</b>		

  

<ul style="list-style-type: none"> <li>➤ The total losses recorded for the year 2021 was Rs.224.22 Mn and it includes three major frauds classified under “External Frauds” and “Internal Frauds” amounting to Rs.40 Mn, Rs.50.3 Mn, and Rs.50.23 Mn respectively.</li> <li>➤ One external fraud amounting to Rs.40 million included in the above involved with the malpractice of funds related to Multi Purpose Co-operative Society ((MPCS)-Matale. The 14 number of fixed deposits related to above society had been closed and relevant amount had been paid in cash contrary to the general instructions related to the fixed deposits indicated that payment should be made only crediting the account of customer or by issuing an “Account Payee” pay order. This incident was recorded in the years 2014 and 2015.</li> <li>➤ There was another external fraud amounting to Rs. 50 Mn involved with the fraudulent withdrawal of funds from the fixed deposit account of Postgraduate Institute of Science, University of Peradeniya. The 14 number of Fixed Deposits had been closed and relevant amounts had been paid in cash contrary to the general instructions related to the fixed deposits indicated that payment should be made only crediting the account of customer or by issuing an “Account Payee” pay order.</li> <li>➤ A Major internal fraud amounting to Rs. 50.23 Mn was identified from pawning advances where the pawning officer had created a fake customers in the pawning system.</li> </ul>	<p><b>Incident</b>                      <b>Details of actions taken</b></p> <p><b>MPCS Matale</b>                      – Investigation on concluded and disciplinary decisions being imposed on 07 staff members.</p> <p>Postgraduate Institute of Science University of <b>Peradeniya</b>                      Investigation on concluded and disciplinary decisions being imposed on 08 staff members.</p> <p>Under file number 8281/138/18 - investigation concluded and</p>
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disciplinary decisions being imposed on 06 staff members.

**Kottawa** Awaiting approval from the Legal Department for the 16 drafted charge sheets.

7 show caused letters were issued and waiting for reply.

Court case pending.  
Main accused interdicted and currently in remand custody.

In addition to above, Regional Risk Officer of each region has been advised to assess the level of adherence to the imposed internal controls during the periodic risk assessments carried out in the Branches of the Region.

### 3.3 Operational inefficiencies

#### 3.3.1. Delays in Construction projects

Audit Issue	Management Comment	Recommendation
3.3.1.1 In the sample review significant delays in completion of construction projects were observed as follows;	Noted the comments.	Need to minimize delays.

Branch name	Contract File number	Cost Estimate (Rs) (before tax)	Offer Date	Due date	As at 31/12/2021 Progress
Head office	2016/20	261,765,370	29/04/2016	15/02/2018	50% completed
Jaffna	: 50/2017	784,713,362	09/05/2017	10/06/2019	Not completed
Kegalle	Tender called by PLPDL	317,682,298	28/05/2019	27/01/2022	32% completed
Matale	Tender called by PLPDL	330,813,315	8/10/2020	24/01/2022	40% completed

3.3.1.2 In the sample review of projects significant delays between project offer date and construction start date were observed as follows;	Noted the comments.
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Branch name	Contract file number	Cost Estimate (Rs)	Offer Date	Date of Construction start	Delays in start up Days
Head Office	2016/20	261,765,370	29/04/2016	6/02/2017	293
Jaffna	Contract 50/2017	784,713,362	09/05/2017	7/12/2017	212
Kegalla	Tender called by PLPDL	317,682,298	28/05/2019	6/10/2020	517
Matale	Tender called by PLPDL	330,813,315	21/05/2019	2/10/2020	520
Mullaitive	Tender called by PLPDL	119,136,308	09/10/2017	8/03/2018	16

3.3.1.3 The Public Procurement Guidelines issued by the Cabinet of Ministers in the year 2006 are used to improve the transparency of the Government Procurement Process, to minimize delays and to obtain the highest financially advantageous and high quality work and supplies. However the bank had not followed said guidelines by stating bank is exempt from Finance Act and failure to develop bank's owned procedure to be followed by the Procurement Agency in carrying out the Bank's own work procurement activities. Accordingly during the period from 2017 to 2021, the estimated value of works amounted to Rs. 7,092 million regarding 11 works were made without following specific procurement guideline.

Though the Bank had purchased Rs. 257.9 million worth of land in the year 2013 for the construction of the proposed Regional Head Office and Branch of People's Bank at Jaffna and 04 years later proposed construction offered to Link Engineering Pvt Ltd at a cost of Rs.597.2 million with tenor of 550 days, the Bank had failed to achieve the desired objective even the 8 years have been passed. Accordingly, due to non-completion of this project on the expected date, bank has incurred Rs. 13.12 million as office rent and security expenses uneconomically.

Bank has been used National Procurement Agency Guidelines (NPA) and standard bidding documents develop by the CIDA over the years for the procurement of Projects. Further Bank owned Procurement policy for works and consultancy services developed subsequently and obtained approval from the Board of Directors for the same in June 2022. Therefore we wish to inform that Bank has followed standard Procurement procedure developed by National Procurement Agency for the highlighted Projects until the bank owned Procurement manual was developed for the works and consultancy services. As noted previously, delay for the

Although the management comment stated that bank had followed NPA guidelines several non compliances were observed with NPA guidelines. Hence in future bank need to be adhere with owned Procurement Policy for works and consultancy services approved in June 2022.

Selection and recruitment of consultants had not been done in accordance with the procurement guidelines and the procurement work had not been carried out in a transparent manner which evidenced the consulting firm (Design Group Five International (Pvt) Ltd) had commenced work prior to the assignment of the consulting work. The cost of contract administration and supervision of this project was Rs.26.5 million or 4.5 per cent of estimated project cost. According to the terms of the contract, the contractor will have to employ 12 technical officers, including the project manager and engineers in full-time and part-time on the project. When considering the physical deficiencies in the completed part of the construction and the payments made for the contract administration, it is doubt about the 12 officers were deployed full time and part time and whether they were properly supervised.

Furthermore it was observed that the contract agreement had been terminated due to construction of this project is showing greater delays than planned, work site disruptions, low attendance of daily workers, non-availability of essential materials and goods in the workplace, shortage of material samples and technical submissions, improper submission of progress reports and inability to submit bar charts properly. Accordingly, weaknesses in the work of selecting the consulting firm, preparing the bidding documents, evaluating the bidding, selecting the contractor, concluding the contracts, executing the contract work, overseeing them and fulfilling the responsibilities of the consulting firms are the main factors influencing the termination of this contract.

Bank had incurred cost of Rs.204.84 million or 27 percent of estimated cost and since the change of foreign currency value and increase of material prices the estimated cost of Rs. 659.08 million for non completed works had been initially revised to Rs. 634.62 million and again revised to Rs. 693.65 million.

construction of Proposed RHO and Branch Project at Jaffna occurred due to the unexpected situation of poor performance of the originally awarded contract for the which resulted contract termination subsequently, as well as Covid 19 Pandemic situation arose in year 2020/2021 which resulted cut down of capital expenditure projects. Although Contractor has provided necessary project supervision staff as per the contract project Consultant, PLPDL and Bank has noted continuous delay on Project activities as well as certain difficulties in the construction works. Project Consultant, PLPDL and bank have been continuously instructed to contractor to overcome the delays as well as maintain the quality and workmanship of the work. However the Contractor's response was not been satisfactory at all and finally contract was terminated considering their poor performance. As noted in the audit comments, once the contract was terminated due to poor performance of the contractor, project consultant prepared the tender document and engineers estimate for the balance work of the project. The balance scope of work again revised including additional scope of work related to External works and certain provisional sum activities to

cover the total scope of the project. Further, additional cost involvement for the completion of balance scope of work of the project due to price increment of material, labour, plant can be substantially recovered from the encashed performance bond of original contractor value Rs. 59.72Mn. Board Approval has been granted to award the contract for completion of balance works of proposed Regional Head office and Branch Building at Jaffna on May 2022 and accordingly, contract has been awarded to M/S Sanken Constructions (Pvt) Ltd on June 2022. Construction of balance works of proposed Regional Head Office and Branch Building is in progress.

### 3.4 Loan Administration

Audit Issue	Management Comment	Recommendation
<p>3.4.1 The bank had granted loans totaling to Rs. 778,056.37 million during the year 2021 and out of that Rs.12,239.40 million had been transferred to non performing category as at 31December 2021. Out of that Non -Performing loans, there were loans amounting to Rs. 1,015.83 million where even a single installment had not been recovered. Out of that any capital installment from loan amounting to Rs.987.89 million and any interest from loam amounting to Rs. 27.94 million had not been recovered as at 31 December 2021.</p>	<p>Noted the comments.</p>	<p>Need continuous follow-ups on non performing loan recoveries.</p>

3.4.2. Non - Performing (NP) Ratio of the bank has increased continuously over last five years as follows.

Year	2017	2018	2019	2020	2021
NP ratio %	1.9	2.5	3.3	3.2	3.2

It is acceptable that the gross loans NP ratio has been substantially increased during the last 05 years. Slight increase can be observed during the year 2017 – 2018. However, considerable increase can be seen merely because of the economic crisis as a result of the Easter attack and subsequent impacts. However, vigorous recovery drive was initiated to prevent the situation and get back to normalcy.

Need continuous follow-ups on non performing loan recoveries.

3.4.3. Analysis of the amounts written off over last five years from 2017 to 2021 with the amount recovered out of written off advances are as follows.

Year	Amount written off (Rs. Mn)	Amount Recovered (Rs. Mn)	Percentage of Amount Recovered against Amount written off
2017	102.14	30.29	29.66%
2018	42.35	25.96	61.30%
2019	219.66	71.53	32.56%
2020	195.70	13.57	6.93%
2021	119	15.29	12.85%
Total	750.85	156.64	20.86%

The Bank adopted the write off policy for unrecoverable NP debts in every year as applicable, for the purpose of proper reflection of books of accounts. Every possible recovery measures have been continued to recover such write-off advances. Further, the recovery of write-off debts have been set as a key performance indicator of the Recoveries Department and is closely monitored on monthly basis, to ensure the effectiveness of recovery process.

Need continuous follow-ups on recoveries of loans.

3.4.4. Total outstanding of top 10 non-performing loans (NPLs) as at 31 December 2021 was Rs.53,741.75 million including the capital of Rs.28,658.73 million and interest of Rs.25,083.04 million which represents 47.8 percent of total gross NPLs and advances. Out of that Rs. 30,627 million or 51.1 percent from above advances do not have any securities and Rs. 3,182 million or 5.31 percent from above advances do not have adequate securities.

Noted the comments.

Need continuous follow-ups on recoveries of loans.

Name of the customer	Capital Balance Rs.million	Interest Balance Rs.million	Total Balance Rs.million
01 The Co – operative wholesale Establishment	5,239.64	203.55	5,443.19
02 CML Group	3,472.54	1,555.51	5,028.05
03 The Grand Mountain Hotel (Pvt) Ltd	3,450.64	234.67	3,685.31
04 W M Mendis and Company Ltd	3,136.60	106.15	3,242.75
05 Yashoda Group	3,040.41	21,731.13	24,771.54
06 SREI Equipment Finance Ltd	3,011.25	162.26	3,173.51
07 Mihin Lanka (Pvt) Ltd	2,564.71	1.55	2,566.26
08 Huravee International (Pvt)Ltd	1,907.13	614.09	2,521.22
09 Daya Apperal Group	1,460.24	407.36	1,867.60
10 Nawaloka Group	1,375.57	66.75	1,442.32
<b>Total</b>	<b>28,658.73</b>	<b>25,083.02</b>	<b>53,741.75</b>

3.4.5. Analysis of the Top 10 non-performing loan customers and balances movement for last 5 years is as follows.

Top 10 NPL balances during the period of 2017 – 2021 have been increased mainly due to appreciation of foreign currency. A part of the capital debt availed by CWE, CML MTD Group, Mihin Lanka , Daya Apparel Group, Nawaloka Group along with accumulated interest has been recovered during the period. Aggressive recovery actions have been initiated to recover the remaining NP debts.

Need continuous follow-ups on recoveries of loans.

Name of the Customer	Rs. million				
	2017	2018	2019	2020	2021
Yashoda Group	21,635.8	22,416.7	23,197.6	23,980.6	24,771.5
CML MTD Group		2,746.6	4,041.3	4,680	5,028.05
Mihin Lanka (pvt) Ltd		2,578.6	2,868.3	2,502	2,566.26
W M Mendis and Company Ltd			2,674.6	3,875.7	3,242.75
Huravee International (Pvt) Ltd			1,926.6	2,178.8	2,521.21
Daya Apperal Group			785.5	1,943.2	1,867.60
Nawaloka Group			570.28	1,699.2	1,442.33
Good Fellows (PVT) Ltd	1,387.9	1,704.9	1,742.6	1,905.2	
Rican Lanka (pvt) Ltd	1,636.3	2,025.3	1,937.5		
Graline Express(pvt) Ltd	4,609.3	4,714.6			
The Grand Mountain Hotel (pvt) Ltd		447.2		3,563.9	3,685.31
City Construction Contractors(PVT) Ltd	973.1	861.3		1,036.4	



E W Information systems Ltd	1,022.4	1,122.1			
Rusirumal (Pte) Ltd	431.5				
Ruhunu Development Contractors & Engineers	323.5				
Kotagala Plantation	271.9				
Tech Information Solution (pvt) Ltd	162.7				
Lanka Ceylon PLC		683.4			
Lankem Ceylon PLC			851.6		
The Co-operative wholesale establishment					5,443.19
Equipment Finance Limited					3,173.51
<b>Total</b>	<b>32,454.4</b>	<b>39,300.7</b>	<b>40,595.7</b>	<b>47,365.0</b>	<b>54,741.7</b>
Increase of top 10 NPL compared to previous year (Amounts)		6,846.32	1,295.04	6,769.30	7,156.21
Increase of top 10 NPL compared to previous year (%)		21.1%	3.3%	16.7%	15.1%

- By 2021, Top 10 NPL balance was increased by 68.67 percent or Rs. 22,287.35 million compared to 2017.
- According to the above analysis Yashoda Group is continuously remaining in the Top 10 Non- Performing borrowers over last five years. CML MTD Group, Mihin Lanka (pvt) Ltd and W.M. Mendis and Company Ltd, Huravee International (PVT) Ltd, Daya Apparel Group and Nawaloka Group are continuously stand in the Top 10 non performing loans for last three years. The Co-operative Wholesale Establishment (CWE) and SREI Equipment Finance Limited are newly added to the Top 10 non performing loans list during the year 2021.

3.4.6. Government Exposure-Summary of last five years

Noted.

Need follow ups on SOEs loan balances with maintaining proper limits.

Total outstanding balance of loans & advances belongs to State Owned Enterprises (SOEs) have been increased significantly in last five years. By 2021, total outstanding balance of loans & advances belongs to SOEs have increased by 165% percent or Rs. 584,107 million compared to 2017. Annual growth of year 2018, 2019, 2020 and 2021 comparing to previous year were 56%, 9.11%, 40.55% and 10.96% respectively. In year 2017, total outstanding balance of SOEs' was 32.89 percent from total loan & advances and 24.08 percent from total assets of the bank. These percentages grew rapidly to 48.39 percent from total loan & advances and 35.40 percent from total assets as at 31 December 2021. Although the bank's total asset base increased up to Rs. 2,647,641 million as at 31 December 2021, 35.40 percent and 25.39 percent represented by the "loans & advances" to SOEs and "investment & receivables from government respectively. Accordingly total exposures of government on bank's assets represent approximately 60.79 percent. Total payable by bank to government (Borrowings, Deposits and Equity) was Rs. 362,799 million which represent 13.70 percent of total assets.

	2017	2018	2019	2020	2021
Loans & advances belongs to SOEs	353,279	551,110	601,297	844,821	937,386
Increase of SOEs balance compared to previous year		197,821	50,197	243,525	92,564
<b>Increase of SOEs balance compared to previous year (%)</b>		<b>56.00</b>	<b>9.11</b>	<b>40.55</b>	<b>10.96</b>
Total loans & advances	1,074,248	1,334,420	1,386,481	1,723,466	1,936,974
<b>SOEs loan balance out of Bank's total loans &amp; advances (%)</b>	<b>32.89</b>	<b>41.30</b>	<b>43.37</b>	<b>49.02</b>	<b>48.39</b>
Total Bank's assets	1,467,099	1,734,703	1,873,406	2,230,119	2,647,641
SOEs loan balance out of total assets (%)	24.08	31.77	32.10	37.88	35.40
Investment & other receivable from government	278,676	328,158	419,217	435,343	672,155
<b>Total asset exposure of SOEs</b>	<b>631,954</b>	<b>879,257</b>	<b>1,020,514</b>	<b>1,280,164</b>	<b>1,609,540</b>
SOE exposure out of total assets (%)	43.08	50.69	54.47	57.40	60.79
<b>Total payable to SOEs (Borrowings &amp; Deposits) &amp; Equity</b>	<b>182,559</b>	<b>271,085</b>	<b>217,791</b>	<b>222,257</b>	<b>226,722</b>
					<b>136,077</b>

3.4.7 Top 10 SOEs' loans as at 31 December 2021 had been recorded as Rs. 882,840 million with capital of Rs. 873,689 million and interest of Rs. 9,152 million. It represents 94.18 percent of total outstanding balance of loans & advances belong to SOEs. Details of top ten SOEs loans are as follows,

Noted the comments. Need follow ups on SOEs loan balances with maintaining proper limits. Bank has set limits for SOE exposures and taking measures to gradually reduce the

Institute	Outstanding as at 31 December 2021 Rs. Million	Security	Security Value	SOE exposure in 2023.
Deputy Secretary to Treasury	373,918	Clean	-	<p>Wish to highlight the following points with regards to DST exposure.</p> <p>➤ DST account has approved overdraft limit of Rs.373.918Bn as at 31.12.2021. However, it is reduced up to Rs.30.0Bn at present. As per the PB/CEO/GM/RK/H OF letter date 02.09.2022 the bank has requested to further reduce the overdrafts balance up to Rs.15.0Bn with effect from 30.09.2022 onwards.</p> <p>➤ However, as per the Ministry of Finance, Economic Stabilization and National Policies letter date 30.09.2022 under the reference number of TOD/FOA/01/PB/G EN, Secretary to Treasury (Acting) has requested to maintain the existing overdraft limit of Rs.30.0Bn up to end of December 2022.</p>
Ceylon Petroleum Corporation	233,395	Treasury Indemnity	USD 1,657 Mn	
Ceylon Electricity Board	70,004	Treasury Guarantee Mortgage over Receivable Clean (Rs. 29,835 Mn)	Rs. 20,350.08 Mn Rs. 38,800 Mn -	
Road Development Authority	65,803	Treasury Guarantee Treasury Indemnity Letter of Undertaking from General Treasury Assignment of cash deposit	Rs. 35,000 Mn USD 44.7 Mn Rs. 8,380.09 Mn Rs. 12,892.87 Mn Rs. 1.07 Bn	
Sri Lankan Air Lines	43,252	Treasury Guarantee Letter of Comfort from General Treasury	Rs. 13,901.84 Mn USD 12.89 Mn Rs. 13,901.84 Mn USD 101.87 Mn	
Ceylon Fertilizer Company Limited	27,052	Letter of Comfort from General Treasury Fixed Deposits	Rs. 27,147.05 Mn Rs. 1,393.8 Mn	
Director Pensions Colombo Commercial Fertilizer Ltd	23,463	Treasury Guarantee	Rs. 32,467 Mn	
National Water Supplies & Drainage Board	16,978	Letter of Comfort from General Treasury Cash Assignment	Rs. 10,325.75 Mn USD. 40.28 Mn 122.18 Mn	
	14,918	Treasury Guarantee Letter of Undertaking from General Treasury	Rs. 3,961.03 Mn Euro 7,6 Mn Rs. 11,295.92 Mn	
State Pharmaceuticals Corporation	14,057	Letter of Comfort from General Treasury Clean (Rs. 8,000 Mn)	Rs. 6,000 Mn -	

3.4.8 Outstanding balances of Deputy Secretary to Treasury, Samurdhi loan & interest receivable balance of senior citizen deposits from government treasury amounted to Rs. 480,526 millions which were set off by issuing treasury bond instead of set off by paying cash during the years of 2020 and 2021.

Noted.

Need to focus on get settlement through cash.

<b>Rs.Million</b>		<b>2020</b>	<b>2021</b>	<b>Total amount set off</b>
Deputy Secretary to Treasury		201,611	257,000	458,611
Samurdhi loan		-	3,582	3,582
Interest receivable for senior citizen deposits		10,956	7,376	18,332
<b>Total</b>				<b>480,526</b>
		<b>2020</b>	<b>2021</b>	<b>Total amount set off</b>
Deputy Secretary to Treasury		201,611	257,000	458,611
Samurdhi loan		-	3,582	3,582
Interest receivable for senior citizen deposits		10,956	7,376	18,332
<b>Total</b>				<b>480,526</b>

- 3.4.9 Off balance sheet value (Letter of Credits & Bank Guarantees) belongs to State Owned Enterprises as at 31 December 2021 was Rs. 120,663 million and the SOE exposure including the aforesaid off balance sheet value was recorded as Rs. 1,730,203 million and it was 65.35 % of total assets of the bank. Further Rs. 93,378 million or 77.39% of off balance sheet values represented the Letter of Credits (LC) opened on behalf of Ceylon Petroleum Corporation.
- 3.4.7 Even though the Rupee value is depreciating against USD, the bank has entered into many USD/LKR swap agreements to buy USD during the year 2021 as following table and it was observed that the selling rate of USD was lower than buying rate of the USD in most of the instances. Hence the bank has incurred a loss of Rs. 4,063,085,606 (Without adjusting the actual rate at far leg/maturity) on that swap agreements during the year 2021.

Noted the comments. Need follow ups on SOEs limits with maintaining proper limits.

Due to acute USD position of the Bank, we have not established new Letter of Credits (LC) to CPC, hence as at 17.11.2022, there is no LC o/s. However unsettled Usance Bill value of Rs. 74.74 Bn remains as off-balance item of CPC.

Bank was compelled to enter into US\$/LKR SWAP transactions to generate USD funds due to the following factors,

Need more consideration on Foreign Exchange position when opening new LCs.

As a result of the continuous rating downgrades that the country underwent in 2020 and 2021, foreign banks and

#### USD/LKR (Buy) Swaps 2021

First quarter	Second	Third	Fourth	Total
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USD	quarter	quarter	quarter	USD
	USD	USD	USD	
776,210,000	616,750,000	281,255,036	634,440,814	2,308,655,850

financial institutions refrained from providing USD facilities to any Sri Lankan banks including People's Bank. Our USD borrowings as of 31st December 2020 amounted to USD 857.2 million. However, as of 31st December 2021 this figure amounted to only USD 481.75 million.

Furthermore, due to the opening of new LC's for CPC and the inability to purchase USD's from the interbank FX market and utilize these USD's for the settlement of USD loan outstanding amount of CPC, CPC's USD loan outstanding amount increased by US\$ 76.3 million during the year 2021.

The only option available to the bank to fund its USD liquidity shortfall was to enter into USD/LKR SWAP transactions and utilize those USD funds for the payment of USD obligations. If the bank has not taken this course of action, bank would have defaulted

on its USD obligations in 2020/21 itself.

Treasury Unit took measures to inform the ALCO and Board of Directors regarding the FX losses of USD/LKR SWAP transactions on several occasions.

As per the advice of the ALCO, our Corporate Banking Division has taken measures to recover a portion of the SWAP cost from CPC from 21st May 2021 onwards due to the fact that the bank was compelled to enter into USD/LKR SWAPs to fund the USD requirement of CPC.

3.4.8 These USD Swap purchases mainly used for settled the LCs of Ceylon Petroleum Corporation and during the year 2021 the bank had opened LCs on behalf of CPC amounted to USD 1,054,265,967 and EUR 139,736. It was further observed that the bank had exceeded the ALCO approved net FX position limit (USD 25 million long or short) on several instances and net FX position was remained as short mostly on the second half of the year 2021.

Bank has not exceeded the ALCO approved net FX position limit in 2021. Need to adhere with NOP limits.

As a result of the acute FX position that the bank faced, Bank took measures to seek Central Bank of Sri Lanka's (CBSL) approval for the enhancement of NOP negative limit on three occasions on 28.09.2021, 30.10.2021 and 22.11.2021 respectively and received CBSL's approval. Furthermore,

we have received ALCO's approval for the aforesaid NOP negative limit enhancements.

#### 3.4.9 Randiya Distilleries Pvt Ltd

The company is engaged in the business of manufacturing and bottling of liquor. The Company was initially incorporated in 1982 in the name of "Rio Marketing Services Pvt Ltd" and later the name has been changed as "Randiya Distilleries Pvt Ltd". This customer is new to the bank and their current account was opened on 06.05.2020. Bank has granted Rs.250 million facility. As per the section 6.2.4 of the Title 05 of Credit Procedure Manual (CPM) of the bank, Term Loans considered on the security of guarantors including corporate guarantees and/or other movables should be restricted to 3 years unless specifically mentioned. However the aforesaid facility was considered for 05 years, eventhough the facility was granted against the security of two Directors based on the approval of Board Executive Credit Committee (BECC). Furthermore, according to the section 9.6 of the Title 05 of the Credit Procedure Manual, A guarantee of a individual/Corporate entity is not acceptable, if he/she/it appears as a non-performing/past due borrower/guarantor in the Bank or any other financial institution. However it was revealed in the audit ,the aforesaid guarantors had direct and indirect Non Performing records in the CRIB prior to granting the facility.

The deviations were highlighted in the relevant BECC paper (683/2020) which was ratified on 04.08.2020 , and considered on cash flow basis. The facility was rescheduled on or about 31.08.2021 and thereafter company has paid a sum of Rs.30.5Mn irregularly in installments to recover the monthly installments. Consequent to continuous irregular repayments despite repeated reminders, the bank has decided to initiate litigation proceedings against the borrowing Company and the personal guarantee of the Directors.. Next hearing date of the case will be on 25.11.2022.

Need continuous follow-ups on recoveries and adherence with stipulated directions.

#### 4. Human Resources Management

Audit Issue							Management Comment	Recommendation
Description	People's Bank	Bank Of Ceylon	Commercial Bank	Sampath Bank	Hatton National Bank	Noted the comments.	Need necessary actions to effectively use the bank funds while increasing the efficiency of employees.	
No Of Employees	7568	8337	5072	4013	5024			
No of Branches	742	581	287	229	255			
Cost Per Employee (Rs.Mn)	3.01	3.00	3.22	2.38	2.14			
Profit Per Employee (Rs.Mn)	3.13	4.51	4.65	3.10	9.35			
Personal Expenses as percentage of Net Operating Income	29.46	26.61	24.47	23.05	22.91			

- It was observed that though the bank had incurred Rs.3.01 million per employee per year, the profit generated per employee was only Rs.3.13 million for the year 2021. However, other banks had reported profit per employee amounting to Rs.3.1 million to Rs.4.65 million.
- Personnel expenses as a percentage of net operating income of the bank was 29.46 per cent for the year 2021 which representing highest value comparing to other banks reported ranging from 22.91 per cent to 26.61 percent.



## 5. Accountability and Good Governance

### 5.1 Strategic Plan

<b>Audit Issue</b>	<b>Management Comment</b>	<b>Recommendation</b>
Board approved strategic plan covering year 2021-2023 was not available. Although initially bank planned to prepare Strategic plan for the period 2021-2023,since the procurement process of obtaining consultancy services was got significantly delayed year plan for 2021 was prepared and extended up to mid of year 2022.With that covering period had changed .	Board approved Strategic Plans for the period of 2021-2024 are readily available for your perusal.	It is recommended to prepare the corporate plan on a timely manner.