

State Mortgage and Investment Bank -2022

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the State Mortgage and Investment Bank (the “Bank”) for the year ended 31 December 2022 comprising the statement of financial position as at 31 December 2022 and the statement of income and 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 and Finance Act No. 38 of 1971. My comments and observations which I consider should be report 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 Bank as at 31 December 2022, 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 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 or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank’s financial reporting process.

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

1.4 Audit Scope

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 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 Internal Control over the preparation of financial statements.

Audit Issue	Management Comment	Recommendation
a) The Bank had not maintained some key ledger accounts to ensure the reliability of the financial reporting.	GL Accounts pertaining to SLFRS adjustments have been created during the year 2023.	All the required ledger accounts should be maintained.
b) The Bank has not carried out physical inventory verifications for stationary stock amounting to Rs. 14,174,317 since the year 2017.	Independent committee carried out physical inventory verifications for the year ended 2022 and report is being in progress.	Physical inventory verifications for stationary stock should be carried out annually.

1.5.2 Documentary evidences not made available for Audit

Audit Issue	Management Comment	Recommendation
a) A NBT receivable balance amounting to Rs.3,603,588 was observed in financial statements since 2020. It was neither provided the actions taken to claim the refund nor documentary evidences for the returns submitted to claim the refund in order to assess the recoverability of the receivable balance though the NBT was abolished since 01 December 2019.	Our tax consultant was advised to submit refund claim after finalizing of appeal against assessment on DRL.	Auditors should be provided with information and supporting documents to perform audit procedures.
b) Though the Debt Repayment Levy (DRL) was abolished from 01 January 2020, a DRL receivables balance of Rs.15, 591,023 was observed in the financial statement. Upon the inquiry, it was informed that the DRL receivable was retained to settle against an assessment. However, it will not be able to set off such refund, unless refund become qualifies for settlement. Evidences were not furnished related to the refund process of DRL.	Appeal process is being in progress on settling of refund.	Auditors should be provided with information and supporting documents to perform audit procedures.

1.6 Accounts Receivable and Payable

1.6.1 Payables

	Audit Issue	Management Comment	Recommendation
a)	Instances where the installments were received for EPF loans even after the settlement of the loans. Such payments received were credited to the “ Customer Refund Closed Loan Account ” and the accumulated balance of that account was Rs.48,931,177 for the year ended 31 December 2022.	The customer refund account cannot be maintained as zero balance. In addition to that, customers, those who have not opened savings account with bank were sent refund vouchers to mail address via registered post.	Bank should take necessary actions to inform and refund long outstanding balances to customers within reasonable time period.
b)	Payments made by customers to their loan accounts were credited to a ledger account named “ Un Appropriated Loan Balance Account ” due to multiple reasons without being credited to the relevant loan account or a saving account of the customer. The accumulated balance of that account as at 31 December 2022 was Rs.62,948,841 relating to 16,138 numbers of loans. Details are given bellow.	Un Appropriated Loan Balance Account (UAP) represents the payments made by the customers to their loan account with multiple reasons. UAP balances vary daily based on client payments and are reconciled monthly. Hence, all amounts which are credited to URP account can be identified easily. However, it is unable to maintain the zero balance on these UR accounts.	Old outstanding balances should be identified and cleared within a reasonable time period.

Year	No. of Loans	Amount (Rs.)
Before 2019	1,982	10,210,250
2019	815	2,159,054
2020	7600	6,333,528
2021	1,341	3,115,966
2022	4,400	41,130,043
Total	16,138	62,948,841

1.6.2 Advances

	Audit Issue			Management Comment	Recommendation																																				
a)	<p>The Non-Performing Loan/Stage 3 Loan Ratio of the Bank as at 31 December 2022 was 19.33 per cent which was above the Licensed Specialized Bank Industry Ratio of 8.4 percent. However, the recoverability of EPF Loans are guaranteed by Central Bank of Sri Lanka and therefore the Non – Performing Loan / Stage 3 Loan Ratio of the Bank which was calculated by excluding the EPF loans shows lower percentage of 9.97 per cent. The details are given below.</p> <table border="1"> <thead> <tr> <th>Description</th> <th>31.12.2022</th> <th>31.12.2021</th> <th>31.12.2020</th> </tr> </thead> <tbody> <tr> <td colspan="4">NPL Ratio (All Loans)</td> </tr> <tr> <td>Total Loans and Advances (millions of rupees)</td> <td>39,702</td> <td>38,287</td> <td>36,672</td> </tr> <tr> <td>Total Non-Performing Loans (millions of rupees)</td> <td>7,675</td> <td>7,602</td> <td>8,412</td> </tr> <tr> <td>Non-Performing Loan / Stage 3 Loan Ratio (%)</td> <td>19.33%</td> <td>19.85%</td> <td>22.94%</td> </tr> <tr> <td colspan="4">NPL Ratio (Excluding EPF Loans)</td> </tr> <tr> <td>Total Loans and Advances (Excluding EPF Loans) (millions of rupees)</td> <td>32,736</td> <td>30,460</td> <td>28,931</td> </tr> <tr> <td>Total Non-Performing Loans (Excluding EPF Loans) (millions of rupees)</td> <td>3,262</td> <td>2,677</td> <td>3,180</td> </tr> <tr> <td>Non-Performing Loan / Stage 3 Loan Ratio (%)</td> <td>9.97%</td> <td>8.79%</td> <td>10.99%</td> </tr> </tbody> </table>			Description	31.12.2022	31.12.2021	31.12.2020	NPL Ratio (All Loans)				Total Loans and Advances (millions of rupees)	39,702	38,287	36,672	Total Non-Performing Loans (millions of rupees)	7,675	7,602	8,412	Non-Performing Loan / Stage 3 Loan Ratio (%)	19.33%	19.85%	22.94%	NPL Ratio (Excluding EPF Loans)				Total Loans and Advances (Excluding EPF Loans) (millions of rupees)	32,736	30,460	28,931	Total Non-Performing Loans (Excluding EPF Loans) (millions of rupees)	3,262	2,677	3,180	Non-Performing Loan / Stage 3 Loan Ratio (%)	9.97%	8.79%	10.99%	<p>Bank Industry ratio was reported as 11.3% and Bank NPL was 10.18%. Bank has made fullest effort to reduce the NPL with Bank approved policies along with the CBSL guidelines Bank effectively followed up methods for recovering EPF loans during the year 2022.</p>	<p>Satisfactory actions need to be taken to minimize the Non - Performing Loan / Stage 3 Loan Ratio of the Bank.</p>
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b)	<p>The bank has granted credit facilities under different product categories. The following observations are made regarding the credit facilities distribution among different product categories and product category wise Non-Performing Loan ratio in past three year's period.</p>			<p>Recovery action plan for year 2023 has introduced following measures to reduce NPL ratio.</p> <ul style="list-style-type: none"> • Review existing recovery policy • Introduce new Board approved impairment policy • Strengthen recovery staff • awareness programme for 	<p>It is recommended to expand the loan distribution among different product categories and minimize the NPL Ratio at lower level.</p>																																				
i)	<p>Personal, Personal Mortgage, Mortgage and EPF Loan including Estate categories were the main product categories of the Bank during the past three years period which contributed 95 per cent of the total loan portfolio of the Bank.</p>																																								
ii)	<p>Contribution of the Bank by granting loans towards the other sectors of the economy including micro and SME sectors are insignificant.</p>																																								
iii)	<p>The Estate Loan category and the EPF Loan category record the highest NPL ratios of the Bank during the past three year's period.</p>																																								

all recovery staff

- Expansion of Revival /Restructure unit with adequate staff
- Review of watch list handling and early warning classification of sick loans
- Select 10 Higher NPL branches and arrange special recovery programme
- Two months declared as special customer care and relationship months to improve loan recoveries

Industry	2022			2021			2020		
	rupees in millions	%	NPL %	rupees in millions	%	NPL %	rupees in millions	%	NPL %
EPF Loans	5,270	14.37	69.52	4,634	12.10	69.55	4,510	11.36	65.57
Mortgage	7,349	20.04	12.96	7,032	18.37	11.79	6,916	17.42	11.56
Vehicle Loans	0.5	0.00	-	-	-	-	-	-	-
Personal	17,704	48.28	8.62	19,532	51.02	7.67	20,142	50.73	8.99
Refinance	128	0.35	12.54	82	0.22	19.17	46	0.11	30.14
Investment Fund	47	0.13	25.70	30	0.08	29.22	18	0.04	35.64
Personal	3,269	8.91	13.95	4,161	10.87	9.58	4,479	11.28	11.20
Mortgage									
Micro and SME	364	0.99	16.98	547	1.43	12.30	1,155	2.91	11.32
Estate	1,707	4.66	91.80	1,542	4.03	92.55	1,511	3.80	85.29
Others	834	2.27	18.83	727	1.90	18.42	925	2.33	18.08
Average NPL	36,673		22.94	38,287		19.85	39,702		19.33

- c) The top 10 Non-Performing Customers (NPA) were analyzed during the past 2 years' period and the following observations are made.
- i) The aggregated balance of top 10 Non- Performing customers
- The Bank It is
Monitor the recommended to
highest NPL ensure that

was Rs.219,011,142 as at 31 December 2022 and it represents 2.9 percent of total non-performing gross loans and advances of the Bank as at that date.

ii) The aggregated top 10 non-performing customer balance has increased by 58.8 per cent or Rs.81,137,859 as at 31 December 2022 when compared with the preceding year.

clients on satisfactory monthly basis and reported to the BIRMC. Legal actions were taken for highest NPL clients and start the auction processes after 31.12.2023.

on satisfactory customer evaluations have been performed by the bank before granting loans to particular customers. Continues monitoring and follow up action is being done.

Customer CIF No.	Total Outstanding as at 31 December (Rs.)	
	2021	2022
CE2498	-	50,480,651
BL2003	-	26,011,553
PO1629	42,209,654	42,389,181
PM2499	23,536,165	25,090,214
BL1021	-	15,752,744
SV2002	-	14,957,440
PM2681	15,618,527	17,206,162
HJ4815	10,077,073	9,374,734
PM4698	-	9,950,256
PM4608	-	7,798,207
HJ5775	11,871,793	-
HJ5967	10,261,567	-
HJ4020	6,592,230	-
AN1867	5,479,222	-
HJ3376	5,986,036	-
HF8679	6,241,016	-
Total	137,873,283	219,011,142
Increase of top 10 NPL balance compared to previous year	-	81,137,859
% Increase of top 10 NPL balance compared to previous year (5)	-	58.8

- d) There are some customers to whom loans were granted in a particular year and those loans are transferred to NPL category in the same year (Excluded rescheduled facilities). An analysis has been performed towards the top 10 customers who are falling into the above category. It was observed that Rs.46, 988,500 has been disbursed to these 10 customers during the 2022 and the total outstanding balance was recorded as Rs.50,045,034 as at 31 December 2022. The details are given below.
- We are highly concerned on loan recoveries which are granted in the particular year. Bank will setup a standard to maintain NPL below 1% loan granted in particular year and immediate recovery action to be taken.
- It is recommended to ensure that satisfactory customer evaluations have been performed by the bank before granting loans to a particular customer.

No.	CIF No. of the Customers	No. of Loans	2022 Total Amount Disbursed (Rs.Mn)	Balance Outstanding as at 31.12.2022 (Rs.Mn)
1.	SV2002	1	14,038,500	14,957,440
2.	HJ6841	1	6,800,000	7,475,988
3.	PM4761	1	3,990,000	4,342,812
4.	HJ6694	1	3,900,000	4,260,888
5.	PU4114	1	3,400,000	3,449,583
6.	PU 4561	1	3,160,000	3,200,956
7.	PM4797	1	3,000,000	3,120,436
8.	PU4952	1	3,000,000	3,111,175
9.	PGD946	1	2,850,000	3,068,475
10.	PU3905	1	2,850,000	3,057,281
Total			46,988,500	50,045,034

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
a) Public Enterprises Circular No. PED 03/2016 dated 29 April 2016.	Bank had paid Pay as You Earn (PAYE) tax amounting to Rs.5,628,889 for the year 2022 out of its own funds on behalf of its employees instead of being deducted from salaries of respective employees.	With effect from January 2023 PAYE tax has been deducted from salaries of respective employees.	Bank should comply with relevant PED circular Instructions.

b)	Para No. '4' of the Presidential Secretariat Circular No. PS/GPA/Circular/36/2020 dated 10 December 2020.	Annual advertising program should be submitted to the Department of Public Enterprises (PED) for approval. However, the bank has incurred advertising expenses of Rs.17,329,178 for the financial year 2022 without obtaining the relevant approval.	Marketing budget was included in the board approved annual budget for the financial period of 2022.	Bank should comply with relevant circular instructions.
c)	Section 3.1.i.e of the Banking Act Direction No.12 of 2007.	The Board of directors should review the adequacy and the integrity of the Bank's internal control systems and management information systems. However at present the Bank uses AS 400 as their MIS system which does not facilitate the industry requirements in terms of generating information and reports.	New core banking implementation project started and analysis and design phase of the project is being on progress.	The Board should ensure the adequacy and the integrity of the Management Information System of the Bank.
d)	Public Enterprises Circular No. PED 1/2015 dated 25 May 2015.	The officers who are entitled to official assigned vehicles or a transport allowance are not permitted to any other official vehicle including those in the vehicle pool. However, former chairman was paid the vehicle allowance and the fuel allowance for his personal vehicle from January 2020 to January 2022 while an official vehicle was assigned from Ministry of Finance and Policy Development. Furthermore, another official vehicle from SMIB was assigned since February 2022. Accordingly, former chairman has been provided with an additional transport facility until 23 August 2023.	This concern is not acceptable. Even though the Bank has obtained a vehicle from the Ministry of Finance, the said vehicle was not reliable for use of the Chairman at the time of acquisition. Hence, was not assigned to the Chairman. This vehicle has been used for different requirements of the Chairman's Office and other affairs of the Bank during the period.	Bank should use its assets efficiently and comply with relevant circulars.

1.8 Non-compliance with Tax Regulations

	Audit Issue	Management Comment	Recommendation
(a)	According to the Schedule 02(c) of the Extraordinary Gazette No: 1868/10 which was published on 23 June 2014 by the Commissioner	Subscriptions to institutions include the annual fees paid to Central Bank, Employer's Federation, Sri Lanka Banking Association, etc. Hence the	Subscriptions paid on behalf of the employees should be considered when

General of Inland Revenue relevant to the Value Added Tax on Financial Services, emoluments should include aggregate benefits paid both in money and not in money. Furthermore, according to appendix 01 of the Inland Revenue Act, institutional subscription fees paid shall be considered under the code no: 76 of VAT on FS return format. However subscriptions paid by the Bank on behalf of the employees had not been considered when calculating the VAT on Financial Services.

significant amount of subscription to institutions not directly represents the benefit provided to employees.

calculating the VAT on Financial Services.

- (b) According to the Extraordinary Gazette No: 2303/05 issued on 25 October 2022, Bank shall consider the impairment under stage 03 as the allowed expense. However, entity had not complied with the requirement and individual impairment was allowed while disregarding the collective impairment under stage 03 category which may create additional income tax payable and excess cash out flow to the Bank.
- Normally majority of the loans in the stage 3 under collective impairment are subject to move up or down based on DPD. Therefore, to ease the future complication on claiming of tax credit on impairment provision Bank has recognized only individual impairment under tax base.
- Bank should comply with the Cited Directions.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a loss of Rs.89,005,118 and the corresponding profit in the preceding year amounted to Rs.405,197,439. Therefore, a deterioration amounting to Rs.494,202,557 of the financial result was observed. The main reason for the deterioration is the decrease of net interest income by Rs.363,209,042 comparing to the previous year.

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 Increase/ (Decrease) (Rs'000)	Variance (%)	Reason for the Variance
Interest Income	2,148,306,082	41	Increase of interest rates of existing and newly granted loans and advances.
Interest Expenses	2,511,511,124	85	Increase of interest rates on savings and fixed deposits.

Fee and Commission Income	(47,060,768)	-16	Reduction of new lending during the year.
Net Other Operating Income	(3,158,905)	-11	Reduction of dividend income from financial assets measured a fair value through Profit or Loss.
Income tax expenses	(443,011,236)	-291	Increase of differed tax asset compared with the previous year.

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.

Description	Sector Ratio (2022) %	Bank			
		2022	2021	2020	2019
Profitability Ratio					
Return on Average Equity (ROE)	2.3	3.17	4.11	6.09	7.73
Return on Average Assets (ROA)	0.1	(0.16)	0.76	1.15	1.11
Net Interest Margin (Percentage)	2.8	3.52	4.34	4.24	4.52
Capital Adequacy					
Basel III – Tier I (Minimum 8%)	14.2	18.36	21.91	21.58	21.04
Basel III – Total capital (Minimum 12%)	17.7	20.41	23.87	22.67	21.77
Asset Quality					
Gross Non- Performing Advance (Excluding EPF Loans)		-	9.19	10.71	7.73
Stage 3 Loans to Loans and Advances (Excluding EPF Loans)	8.4	10.19	-	-	-
Liquidity Ratios					
Liquidity Coverage Ratio	196.3	148.1	115	116	121.05

Following observations are made in this regard.

- i) Return on Equity (ROE) had been decreased by 0.94 percent as at 31 December 2022 when compared with the preceding year mainly due to decrease in profitability in 2022.
- ii) Return on Assets (ROA) had become negative 0.16 per cent as at 31 December 2022 due to incurring of after tax loss in 2022.

3. Operational Review
3.1 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
The unidentified balance of Rs.2,361,384 which was coming since 2017 had been written off during the year under review after obtaining approval from the Board of Directors.	Management comment was not provided.	The Bank should obtain and maintain all documentations relevant to particular balances to ensure recoverability.

4. Accountability and Good Governance
4.1 Submission of Financial Statements

Audit Issue	Management Comment	Recommendation
The financial statement signed by the Board of Directors had been submitted to the Auditor General on 27 July 2023 after delaying of five months period.	Non constitution of the Board of Directors until end of June 2023 was resulted to such delay.	Ensure the timely submission of Financial Statements to the Auditor General.