

NSB Fund Management Company Limited - 2023

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the NSB Fund Management Company Limited (“Company”) for the year ended 31 December 2023 comprising the statement of financial position as at 31 December 2023 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 material accounting policy information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018. My comments and observations which I considered would 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 Company as at 31 December 2023, 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 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 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
i) Out of the total receivable balance of Rs.246,939,587 which is receivable from General Treasury in relation to the appointment of the Company as the lead manager for the reorientation of Sri Lanka Airlines Project in year 2016, an amount of Rs.88,939,587 which is equivalent to 36 percent of the total receivable balance, is remained outstanding since 2016.	We have taken every possible action at our level to recover the balance. The latest request letter with all the supporting documents were sent to the Ministry of Finance on 22.11.2023.	It is recommended for the Company to take necessary steps to recover the due amount without further delay.
ii) An amount of Rs.67,401,151 of income tax receivable has been prevailed since year 2014 due to income tax overpayment.	Previously the Inland Revenue Department (IRD) did not allow claim tax over payments against income tax liabilities prior to finalizing IRD audit. Therefore, we have not claimed it. Now, IRD has allowed it to set off against income tax liabilities and we have set off it against the 4th installment of 2023/24 tax payable.	It is recommended for the Company to take immediate actions to recover income tax receivable without further delay.

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

Reference to Laws, Rules Regulations etc.	Non-compliance	Management Comment	Recommendation
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Section 8.1 of Registered Stock and Securities Ordinance and Local Treasury Bills Ordinance Directions No. 01 of 2019 issued by CBSL.	The company had to pay a penalty of Rs.20,991 to CBSL due to non-allocation of securities as entering incorrect SWIFT messages and owner code on 15 May 2023. However, similar incident of non-allocation of securities on repurchase transaction had been occurred with having charge of Rs.259.957 Mn to CBSL in the previous year.	The Board of Directors of the Company recommended to get disciplinary actions against the responsible officers by way of giving warning letters, suspending increments, and recovering the loss and the actions were taken accordingly and recovered the loss from relevant officers.	The company should comply with the directions accordingly.
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1.7 IT General Controls

Audit Issue	Management Comment	Recommendation
i) As the existing Treasury Management System of the Company has not been connected to the own server or NSB Server, the Company has to perform its backup procedure manually. Thus, there may be high probability of having human errors and recovery issues resulting high risk of data accuracy.	The existing Treasury Management System (TMS) is installed on the NSB FMC Server, located within the NSB FMC premises. It is not connected to the NSB Servers. Backups are taken at approximately 12:00 noon and 5:00 p.m., with copies stored at both the Disaster Recovery (DR) site in Maharagama and a shared folder at the NSB Head Office. NSB FMC has signed an agreement to upgrade the existing TMS to a new version, which will include an automatic backup facility. This automatic backup feature will become operational once the new upgraded version goes live.	It is recommended to automate the backup procedure of the Company in order to ensure data accuracy and validity.

- ii) As the Efixin System of the Company has not been connected with the SWIFT System, there is a high possibility of entering erroneous messages in to the SWIFT system.
- The fully automation process will be finalized with the upgrade of the existing system. However, the following automation process has already been established.
- The Company should implement a fully automated process to prevent the risk of having errors.
- The text file of the sales messages generated from the current system (e FixIn) and directly upload to the SWIFT SERVER for verification and authorization process.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to profit of Rs.1,641,605,934 and the corresponding loss in the preceding year amounted to Rs. 2,025,825,745. Therefore, an improvement amounting to Rs. 3,667,431,679 of the financial result was observed. The reasons for the improvement are increase in net interest income due to increase in interest rates and decrease in borrowing cost.

2.2 Trend Analysis of major Income and Expenditure items

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	757,365,924	32	Increased in interest rates.
Net Interest Income	910,513,314	1761	Decreased in borrowing cost due to decrease in interest rates
Fee & Commission Income	(6,328,772)	(31)	Suspension of NSB custodian fee.
Net Trading Gain/ (Loss) from Financial Instruments at FVTPL	4,794,432,239	190	Decreased in the market interest rates and decreased in average market yield of portfolio.
Personnel Costs	24,730,874	54	Appointed a chief Manager from NSB on secondment basis. Recruited 04 new employees during the year.
Other Expenses	(245,048,699)	(83)	Other expenses marked a higher amount in 2022 due to Central Bank charges in relation to the violation of directions amounting to Rs.260 Mn.

2.3 Ratio Analysis

The following observations are made in some important accounting ratios of the Company for the year under review.

Description	Company	
	2023	2022
Return on Equity (%)	29.8	(54.5)
Return on Asset (%)	9.7	(18.6)
Risk Weighted Capital Adequacy Ratio – (Minimum Requirement – 10%)	21.3	36.7

3. Operational Review

3.1 Identified Losses

Audit Issue	Management Comment	Recommendation
i) The company had to incur a net loss of Rs.782,815 due to non-submission of 03-months treasury bill bids at the auction conducted on 29 August 2023.	The Company has already taken actions against the relevant Officer by way of issuing a warning letter, holding annual increment and transferring to another department with the recommendation of the Board after conducting an investigation by the Internal Audit of the Bank. Further an Officer assigned for Bids authorization who seconded to the Back Office from Sri Lanka Savings Bank. Instruction guidelines have been issued with the circulars to strengthen the internal controls.	The Company should implement strong internal controls and follow up the continuation of those controls.
ii) The Company had over-allocated the securities for Open Market Operations (OMO) borrowings on 16 March 2023 due to erroneously recording of 08 deals instead of 07 deals in CBSL browser. Thereby, the Company had to incur a total loss of Rs.2,217,031 as it had to find the security from the market to honor the OMO deal in the situation where there were no adequate stocks to pledge for 08 deals.	On the recommendation of the ALCO and Board issued warning letters to responsible Officers. Further, internal controls were also strengthened by issuing internal circulars.	The Company should implement strong internal controls and follow up the continuation of those controls.

3.2 Management Inefficiencies

Audit Issue	Management Comment	Recommendation
The Board of Directors of the Company had not appointed for the period of January to April 2023 (04 months) which may hinder the operations of the Company with the absence of the approvals for the strategic decision making.	The NSB FMC is a fully owned subsidiary of the NSB and the Board of Directors of the NSB recommend the Members to the Board of NSB FMC. The said period of January to April 2023, there was no proper fully functioning of the Board of NSB, since the Chairman position was vacant and therefore no Member was nominated as the Chairperson to the Board of NSB FMC to conduct the Board Meetings.	The proper procedure should be arranged for the appointment of Board of Directors in collaboration with the relevant authorities.

3.3 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
i) The Company had not assigned an audit officer on daily basis to verify the routine transactions of government securities in order to avoid the non-compliance & malpractices and risks encountered with the transactions.	We will recruit and assign a daily Audit Officer once the election period is over (Board approval has already been granted).	The Company should assign an audit officer to verify the routine transactions.
ii) As stated in the Letter No.24/13/004/0005/008 dated on 05 June 2023 by Director, Department of Supervision of Non-Bank Financial Institutions, several erroneous FinNet return submissions of the Company were noted recently. This indicated that the respective officers of the Company had not executed their duties with due care. Therefore, there should be a proper mechanism to avoid such kind of repeated errors from officers by increasing individual responsibility of the staff since, similar incidents were noticed even in year 2022 through the respective officers. They were given verbal and written advices/warnings.	Process has been implemented. All FinNet returns have been checked by the Middle Office before submission to the CBSL. Further, Internal controls have been strengthened to avoid these kinds of errors and issued Internal Circulars to adhere to the regulatory requirements.	Internal controls should be strengthened to avoid these kinds of errors and staff should be trained to execute their duties with due care.

3.4 Delays in Projects or Capital Work

Audit Issue	Management Comment	Recommendation
<p>The Company had entered in to an agreement with Credence Analytics Company in India to establish new Treasury Management System by end of March 2020. The Company has already paid USD 267,131 which is equivalent to Rs.53,833,248 and this was 67.5 per cent of the total project cost of USD 395,706.25 with an annual maintenance fee of USD 51,000. However, the Company was unable to obtain the service from the respective supplier on timely manner and later, with the negotiations had between two parties, that company agreed to hand over the system on or before 31 December 2022. Although it has been lapsed nearly 04 years from the agreed date of completion, still the Company could not establish the primary dealing system.</p>	<p>Considering the progress and the time frame of the Credence System, the Board of NSB FMC, advised to seek the advice of the Legal Division of NSB and to write the vendor demanding back the payment paid up to now, since it is very unlikely that they will be able to rectify the issues within the time period which was already lapsed.</p> <p>NSB FMC has already written to the Legal division of NSB to seek their advice.</p>	<p>The Company should speed up the process of implementing new Treasury Management System to smooth the key operations of the Company.</p>

4. Accountability and Good Governance

4.1 Annual Action Plan

Audit Issue	Management Comment	Recommendation
<p>i) Though the Company has planned to introduce a Mobile App for customer convenience in the year 2019, the Company was unable to introduce a Mobile App up to the date of audit on 31 March 2024.</p>	<p>It is planned to introduce a Mobile App after completion of the second phase of the CMS system.</p>	<p>The proposed programs should be implemented in timely manner.</p>
<p>ii) Although it was planned to establish a research and development unit in the year 2020, the Company was unable to establish that unit up to the date of audit on 31 March 2024.</p>	<p>The Company obtains market information from the external party (Frontier Research) and a forward-looking economic review is submitted to the Management on a periodic basis.</p> <p>Even though it has been planned to establish an R & D, it has not materialized with limitation of the business functions such as Trustee Business, Investment</p>	<p>The company should make the necessary arrangements to establish research and development functions.</p>

Manager etc. with the proposed merger decision with NSB. However, the Board has granted its approval to recruit a Research Officer and recruitment will be made once the election period is over.

4.2 Audit Committee

Audit Issue	Management Comment	Recommendation
Although it is required to conduct Audit Committee meeting at least quarterly basis as per Primary Dealer Operational Manual, the Company had failed to comply with the stipulated requirement. Only two Audit committee meetings were held during the year under review.	Sub Committees were appointed on 12.06.2023 due to unavailability of Board. After that, conducted 02 Board Audit Committees for last 02 quarters.	Board Audit Committee should be conducted in compliance with the Audit Committee Charter.