

Sri Lanka Deposit Insurance Scheme - 2023

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Sri Lanka Deposit Insurance Scheme (“Scheme”) 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 statement of cash flows 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(3) of the Constitution of the Democratic Socialist Republic of Sri Lanka, read in conjunction with the National Audit Act, No.19 of 2018 and Section 54(2) of the Banking (Special Provisions) Act, No. 17 of 2023. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the financial statements of the Scheme give a true and fair view of the financial position as at 31 December 2023, and of its financial performance and its cash flows for the year then ended in accordance with the 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 Scheme’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 Scheme or to cease operations, or has no realistic alternative but to do so.

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

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

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

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Scheme'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 Scheme'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 Scheme 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 Scheme, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Scheme has complied with applicable written law, or other general or special directions issued by the governing body of the Scheme;
- Whether the Scheme has performed according to its powers, functions and duties; and
- Whether the resources of the Scheme had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

2. Financial Review

2.1 Financial Result

The operating result of the year under review amounted to a profit of Rs. 24.1 billion and the corresponding profit in the preceding year amounted to Rs. 18.2 billion. Therefore, an improvement amounting to Rs.5.9 billion of the financial result was observed. The main reason for the improvement is the increase of Interest Income from Financial Instruments during the year under review.

3. Operational Review

3.1 Loans to Member Institutions (MIs)

Audit observation	Management Comments	Recommendation
<p>In terms of Section 8.1(ii) of the Sri Lanka Deposit Insurance Scheme Regulations No. 1 of 2010 {Section 8.1(ii) of the Sri Lanka Deposit Insurance Scheme Regulations No. 2 of 2021 effective until 14 November 2023}, secured advances or loans to any MI shall be granted in the instance of a severe liquidity crisis in such member institution. Accordingly, a loan amounting to Rs.6 billion was granted to a MI on 15 December 2014. An amount of Rs.186.7 Mn had been received out of the loan on 27 October 2023 and receivable amount of the loan as at the end of the year under review was Rs.1.3 billion. The licence issued to the said MI to carry out the finance business was cancelled with effect from 22 May 2020 by the Monetary Board of the Central Bank of Sri Lanka (CBSL). Total impairment provision of Rs.1.2 billion had been made in the financial statements up to 31 December 2023 in respect of this loan. A liquidator had been appointed by the winding up court on 21.03.2023. The Scheme had submitted a claim for the outstanding loan as of the date of commencement of the winding up (16.02.2021), as a secured creditor of the MI on 14.08.2023. The settlement of winding up proceeds was in progress as at the end of the year under review.</p>	<p>The Scheme being a secured creditor, would be able to recover its loan balance from the security of the head office property of the particular member institution, which was mortgaged to the Scheme by the particular member institution as additional collateral in 2019 and the submitted claim covers the said property.</p>	<p>Need to recover the outstanding balance.</p>

3.2 Identified Losses

Audit observation	Management Comments	Recommendation
<p>A sum of Rs.137.18 million had been invested on 01 April 2015 in Reverse Repurchase Agreement matured on 31 March 2016 for a sum of Rs 147.05 million with a particular primary dealer by the Scheme. The primary dealer had withdrawn the underlying securities of the above investment without substituting any security with respect to withdrawn securities. Accordingly, an impairment allowance amounting to Rs.144.25 million for the above investment had been made in the financial statements of the Scheme on 31 December 2015. This primary dealer was directed to refrain from participating in government securities primary auctions with effect from 24.07.2017. As per the financial statements and operations of the Central Bank of Sri Lanka for the year 2023, a creditor winding up was field by one of the unsecured investors of this Company and on 17.06.2022 the winding up order was given by the court. However, the winding up case (CHC 83/2021/CO) is still pending before the courts due to other legal proceedings.</p>	<p>CBSL intervened in the Winding Up Case of a particular primary dealer by filing intervention papers with the details of the claim of CBSL as the creditor in March 2023. The Scheme also submitted its claim by way of an affidavit in March 2023.</p>	<p>Need to recover the loss.</p>

3.3 Premium to be levied on insured deposits

Audit observation	Management Comments	Recommendation
<p>According to the Section 7 of the Banking (Special Provision) Act Direction No. 01 of 2023 dated 15 November 2023, Licensed Banks that maintained a Capital Adequacy Ratio of 14 percent or above at the end of the immediately preceding financial year as per its audited accounts as accepted by the Director of Bank supervision, a premium of 0.10 percent per annum should be payable and all other Licensed banks should be payable a premium of 0.125 percent per annum. However, Licensed Finance Companies should be payable a premium of 0.15 percent per annum payable monthly calculated on total amount of all eligible deposit, inclusive of any interest accrued, as at end of the month, irrespective of capital adequacy ratio of each Licensed Finance Company.</p>	<p>As per Section 55 of the BSPA, each member institution shall pay to the Deposit Insurance Fund a premium calculated on the total amount of eligible deposits for such periods, at such rate, at such times, and in such manner as may be determined, from time to time, by CBSL. Accordingly, policy decisions will be taken from time to time, to determine the premium rates as well as the calculation methodology, as appropriate. In exceptional</p>	<p>Need to consider implementing a risk based premium system.</p>

According to the information made available, it was observed that capital adequacy ratio of selected Licensed Finance Companies ranged from 4.85 per cent to 95.66 per cent. Accordingly, it may be necessary to reconsider the premium to be levied from those companies on appropriate basis. According to the performance based conditions stated in the Financing Agreement of the Financial Sector Safety Net Strengthening project, Governing Board of the Central Bank of Sri Lanka requires to approve a methodology for adjustments to the premium rate payable by member institutions in a manner that ensures the build-up and maintenance of the deposit insurance reserves and issue the necessary directions to adjust the premium rates according to such methodology.

circumstances, CBSL shall have the authority to require the member institutions to pay such additional premium to the Deposit Insurance Fund within such period as may be specified by CBSL. The CBSL is in the process of evaluating the required adjustments to the premium rate.

3.4 Payment made out of the Fund

Audit observation	Management Comments	Recommendation
<p>In terms of Sri Lanka Deposit Insurance Scheme Regulations, the payment of compensation shall come into effect in the case of a suspension/cancellation of license as ordered by the Monetary Board on or after 01 January 2012 (effective till 14.11.2023). Accordingly, licences of the seven member institutions were cancelled/ suspended during the years of 2018, 2019, 2020 and 2023 by the Monetary Board. As per the Press release published by the Central Bank of Sri Lanka on 19 March 2021, the Monetary Board of the Central Bank of Sri Lanka had decided to increase the maximum compensation payment under the Scheme from Rs.600,000 to Rs.1,100,000 by Rs. 500,000 in order to provide further relief to the depositors of financial institutions regulated by Central Bank of Sri Lanka in the event of a cancellation or suspension of the licenses of such institutions. According to the information made available, total compensation payable to the depositors of seven finance companies which licenses were cancelled / suspended by the Monetary Board, was Rs. 35,276.3 million and out of that, a sum of Rs. 31,002 million or 87.88 per cent had been paid out of the Fund of the Scheme as at 31 December 2023. The progress on payment of compensation by the Scheme to eligible depositors of the Member Institutions which license was cancelled/suspended is as follows.</p>	Agreed	Need to pay remaining Compensation.

Year (license cancelled/	No of companies	Total Compensation payable (Rs Mn)	Compensation paid up to 31.12.2023 (Rs Mn)	Percentage of payment (%)
2018	2	4,133.21	3,318.46	80.3
2019	1	1,190.74	1,074.31	90.2
2020	3	29,893.72	26,609.95	89
2023	1	58.61	0.27	0.5
Total		35,276.28	31,002.99	88

3.5 Liability to pay Social Security Contribution Levy (SSCL)

Audit observation

The letters sent by the Inland Revenue Department (IRD) dated 08.03.2023 and 10.11.2023 in responses to the appeal submitted by the Scheme, stated that in terms of Section 2(c) of the SSCL Act, No 25 of 2022, the Scheme is liable to pay SSCL at the rate of 2.5 per cent on the 100 per cent of the value addition attributable to financial services calculated by applying the attributable method. However, it was observed that the Scheme had not agreed regarding the payments of SSCL. There was no a final agreement with Inland Revenue Department regarding the Scheme's liability to SSCL up to date. Therefore, the Scheme had not paid any amount of SSCL for the year under review.

Management Comments

The Scheme through its letter dated 09.02.2024 requested the IRD to reconsider its decision based on the following rationale.

01. The Scheme does not carry out a business of providing financial services.

02. Any service provided by CBSL has been identified as one of the exempted services under the SSCL Act.

Recommendation

Need to resolve the matter soon with the IRD.

3.6 Payment of Penalty for default in making premium by member institutions.

Audit observation

According to the Section 7(iii) of the Banking (Special Provision) Act Direction No. 01 of 2023 dated 15 November 2023, where any member institution makes any default in the payments of premium due, such member institution shall be liable to pay to the Central Bank, a penalty for the period of such default. However, a specified time period within which penalty shall be payable, had not been stipulated in the said Direction.

Management Comments

The Scheme is expected to incorporate provisions on a specific time period for settling the due penalty on the defaulted amount in upcoming Directions to be issued to the member institutions.

Recommendation

Need to specify the time period within which penalty shall be payable.

3.7 Financial Sector Safety Net Strengthening Project

Audit observation	Management Comments	Recommendation
<p>The Government of Sri Lanka and International Development Association entered into a financing agreement on 31.01.2024 for the Financial Sector Safety Net Strengthening Project for a concessional financing of USD 150 million (SDR 112.8 million). The objective of the project is to strengthen the financial and institutional capacity of Sri Lanka's financial sector safety net, with the focus on the deposit insurance scheme. The project consists of three parts namely, capitalization of the Scheme), Institutional capacity Building for Central Bank of Sri Lanka and Project Implementation and monitoring which are expected to be implemented in year 2024 onwards.</p>	<p>The project's goal is to increase the Scheme's institutional and financial capacity in accordance with global best practices for effective deposit insurance systems.</p>	<p>Need to achieve the objectives during the implement period .</p>